# INDEX


| | Page |
|---|---|
| Opinions below | 1 |
| Jurisdiction | 1 |
| Questions presented | 2 |
| Statutes and regulations involved | 2 |
| Statement | 3 |
| Reasons for granting the writ | 6 |
| Conclusion | 18 |
| Appendix A | 1a |
| Appendix B | 11a |
| Appendix C | 12a |
| Appendix D | 13a |


## CITATIONS


Cases:

*Riddell* v. *California Portland Cement Co.*, 330 F. 2d 16 ..... 9, 14, 15

*Riddell* v. *Victorville Lime Rock Co.*, 292 F. 2d 497 ..... 14

*Standard Lime and Cement Co.* v. *United States*, 329 F. 2d 939 ..... 9, 10, 11

*United States* v. *Cannelton Sewer Pipe Co.*, 364 U.S. 76 ..... 7, 13

*United States* v. *Portland Cement Co. of Utah*, 378 F. 2d 91, certiorari denied, 389 U.S. 975 ..... 9

*Whitehall Cement Manufacturing Co.* v. *United States*, 369 F. 2d 468 ..... 9, 10, 11, 12, 13

Statutes:

Act of September 14, 1960, P.L. 86–781, 74 Stat. 1017, Sec. 4 ..... 4




339–874—69——1

Statutes—Continued

Page

Internal Revenue Code of 1939:
Sec. 23 ..... 4, 7, 13a
Sec. 114 ..... 4, 7, 13a
Internal Revenue Code of 1954:
Sec. 611 ..... 7, 13a
Sec. 613 ..... 4, 7, 14, 15, 13a
Public Debt and Tax Rate Extension Act of 1960, P.L. 85–564, 74 Stat. 290, Sec. 302 .. 4, 13a
Revenue Act of 1942, c. 619, 56 Stat. 798, Sec. 145 ..... 13a
Revenue Act of 1943, c. 63, 58 Stat. 21, Sec. 124 ..... 13a
Revenue Act of 1950, c. 994, 64 Stat. 906, Sec. 207 ..... 13a
Revenue Act of 1951, c. 521, 65 Stat. 452, Sec. 319 ..... 13a

Miscellaneous:
H. Conf. Rep. No. 2005, 86th Cong., 2d Sess .. 15
*Mineral Facts and Problems*, Bureau of Mines Bulletin 630 (1965 ed.), p. 189 ..... 16
Paton and Littleton, *An Introduction to Corporate Accounting Standards* (American Accounting Association, 1940) ..... 9
Rev. Rul. 290, 1953–2 Cum. Bull. 41 ..... 15
Treasury Regulations 103, Sec. 19.23(m)–1 ... 4, 8
Treasury Regulations 111, Sec. 29.23(m)–1 ... 4
Treasury Regulations 118, Sec. 39.23(m)–1 ... 4, 15a
Treasury Regulations on Income Tax, Sec. 1.613–3 (33 F.R. 10692; 26 C.F.R., Sec. 1.613–3) ..... 5, 11, 13, 16a

# In the Supreme Court of the United States

OCTOBER TERM, 1968

No. —

UNITED STATES OF AMERICA, PETITIONER

*v.*

IDEAL BASIC INDUSTRIES, INC.

**PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE TENTH CIRCUIT**

The Solicitor General, on behalf of the United States of America, petitions for a writ of certiorari to review the judgment of the United States Court of Appeals for the Tenth Circuit in this case.

## OPINIONS BELOW

The findings of fact and conclusions of law of the district court (R. 64–77)[1] are not officially reported. The majority and dissenting opinions of the court of appeals (App. A, *infra,* pp. 1a–10a) are reported at 404 F. 2d 122.

## JURISDICTION

The judgment of the court of appeals was entered on August 15, 1968 (App. B, *infra,* p. 11a). The government's petition for rehearing *en banc* was denied

[1] "R." references are to the printed record in the court of appeals. "App." refers to the appendices to this petition.

on January 20, 1969 (App. C, *infra*, p. 12a). The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

## QUESTIONS PRESENTED

Where the depletable "gross income from mining" of an integrated miner-manufacturer of cement must be determined under the "proportionate profits" method, *i.e.*, an allocation of the receipts from the sale of its manufactured product to the mining phase of its operation in the ratio that its mining costs bear to its total (mining plus non-mining) costs:

1. Whether, in determining the ratio of mining to total costs, post-manufacturing costs of storage, distribution and sales may be left out of account, as the court below held, or are to be considered non-mining costs and included as part of the total cost figure?

2. Whether, in determining the amount of income to be allocated in accordance with the cost ratio, the income is to be computed on the assumption that only cement sold in bulk is the first marketable product, even though respondent sold substantial quantities of the same cement in bags at higher prices and with higher post-manufacturing costs?

3. Whether respondent's "mining" costs with respect to calcium carbonates include the expense of processing mineral additives purchased from and separately depleted by other miners?

## STATUTES AND REGULATIONS INVOLVED

The applicable provisions of the Internal Revenue Code of 1954 and the regulations thereunder are set forth in Appendix D, *infra*, pp. 13a–20a.

## STATEMENT

Respondent is an integrated producer of portland cement, with mining and manufacturing facilities in a number of southern and western states. The major ingredient of portland cement is calcium carbonate, derived from limestone or other deposits (such as oyster shell) with a high calcium carbonate content. Except for its Gulf Coast operations, where it uses shell, respondent mines its own calcium carbonate deposits and crushes the raw mineral. It then grinds the material into kiln feed, in some cases adding purchased sand, sandstone, oyster shell and iron ore to produce a feed with properly balanced constituents. The kiln feed is heated in rotary kilns to produce clinker, and the clinker is then ground together with gypsum to produce the finished cement powder, which is stored in silos. (R. 66–67, 70–74.)

During the taxable years in question (1951 through 1954) respondent sold cement both in bulk and in bags. It sold bulk cement directly from the silos at various plants and from its distribution terminal at New Orleans. It advertised its cement widely and operated sales offices in eleven states. The costs of marketing bulk cement included the costs of bulk loading, transportation and, as to two plants, the operation of the New Orleans terminal, and reloading there for shipment. Some bulk cement was bagged at various plants and some at the New Orleans terminal. Cement in bags was sold from the plants, the New Orleans terminal and respondent's warehouse in Salt Lake City. The costs of bags and bagging were above those incurred in marketing bulk cement, and respondent

charged an additional price for cement in bags (the "bag premium"). (R. 68, 73–74.)

In its complaint as originally filed in the district court on April 21, 1959, as in the underlying claims for refund, respondent contended that its "gross income from mining" for determining its depletion allowance for the years 1951 through 1954 should be computed on the basis of the sales price of finished cement. (R. 69.) [2]

Thereafter, however, respondent filed amended returns for the taxable years and an amended complaint reflecting its election to compute its "gross income from mining" for the taxable years at the kiln feed cut-off point. (R. 68–69.) [3] It was undisputed that respondent's "gross income from mining" at the kiln feed cut-off point had to be determined under the proportionate profits method. (R. 68, 74–75.) This method has been prescribed by successive Treasury Regulations since 1940.[4] It allocates the gross

---

[2] The applicable statutory provisions for the taxable years 1951 through 1953 were Sections 23(m) and 114 of the Internal Revenue Code of 1939. The successor provisions applicable to the taxable year 1954, set forth in Section 613(a) and (b) of the 1954 Code, are substantially similar to the extent pertinent here, and are set forth in Appendix D, *infra*.

[3] This election was authorized by Section 4 of the Act of September 14, 1960, P.L. 86–781, 74 Stat. 1017, and allowed respondent to compute its "gross income from mining" for the taxable years under Section 613(c)(4)(F) of the 1954 Code, as added by Section 302(b) of the Public Debt and Tax Rate Extension Act of 1960, P.L. 86–564, 74 Stat. 290.

[4] Treasury Regulations 103 (1939 Code), Section 19.23(m)–1(f); Treasury Regulations 111 (1939 Code), Section 29.23(m)–1, applicable to the taxable year 1951 herein; Treasury Regulations 118 (1939 Code), Section 39.23(m)–1(e)(3), Ap-

sales price of the integrated miner-manufacturer's first marketable product between the mining and non-mining phases of its operations in the same ratio as the costs of its mining processes bear to its overall costs.

At trial the use of the proportionate profits method gave rise to several questions regarding the proper treatment of certain of respondent's costs. The district court sustained respondent's contentions 1) that all of respondent's post-manufacturing costs of storage, distribution, and marketing should be allocated between mining and non-mining costs in the same ratio that mining costs bore to the total of mining and manufacturing costs; and 2) that respondent's costs of bags and bagging should be allocated in the same manner. The court also ruled that respondent's gross receipts from sales of cement in both bulk and bags was the income figure to be allocated in accordance with the cost ratio, a subject that was not then disputed. Finally, it ruled that respondent's costs of processing purchased additives, extracted and depleted by other miners, should be included in respondent's "mining" costs with respect to the mining of its calcium carbonate deposits.[5]

---

pendix D, *infra*, applicable to the taxable years 1952 and 1953; Section 1.613–3(d), Appendix D, *infra*, applicable to the taxable year 1954.

[5] Additional issues were raised as to the timeliness and merits of amendments respondent made to its claims for refund and its complaint. Those amendments involved the proper classification of certain minerals mined by respondent and the depletion rates application thereto. Both courts below ruled that the amendments were timely and that respondent's contentions as to rates were correct. See App. A, *infra*, pp 2a–3a. Those rulings are not questioned here.

The majority of the court of appeals rejected the district court's theory for apportioning post-manufacturing costs, agreeing with the government that such costs are non-mining in their entirety. However, it ruled that such costs (Appendix A, *infra,* p. 6a) "are not a proper part of the * * * computation", *i.e.,* should not enter into the total cost figure in the cost ratio. In arithmetic result, this was the same as the district court's, *i.e.,* income is to be allocated by the ratio that mining costs bear to the total of mining plus manufacturing costs. The majority further accepted respondent's alternative argument on appeal that its costs and receipts should be determined on the assumption that all of its cement was sold in bulk, reversing the district court's ruling that sales in bags should be taken into account. Finally, it sustained the district court's ruling that the costs of processing purchased additives are mining costs. The United States' resulting petition for rehearing *en banc* was denied (App. C, *infra,* p. 12a).

## REASONS FOR GRANTING THE WRIT

The rulings below are variously in conflict with the views of the Courts of Appeals for the Third and Ninth Circuits and the Court of Claims. The result is confusion and uncertainty in an area of tax law that affects, in the first instance, the numerous members of the integrated portland cement industry who are located throughout the country. Potentially affected are all integrated miner-manufacturer industries, since the proportionate profits method is necessarily applied in computing the depletion allowances

of their members. Only through review by this Court can the conflict and confusion be resolved and a uniform method be established for nationwide application.

1. Section 611(a) of the Internal Revenue Code of 1954, App. D, *infra,* p. 13a, authorizes—as did Section 23(m) of the 1939 Code—a "reasonable allowance for depletion" of natural deposits "in all cases to be made under regulations prescribed by the Secretary or his delegate". In the case of hard minerals, the allowance is a specified percentage of "gross income from mining". Sections 613(a) and (b) of the 1954 Code, App. D, *infra,* pp. 13a–14a. The rate for limestone (or calcium carbonate rock), from which cement is made, was 10 per cent under the 1939 Code provision applicable to the taxable years 1951 through 1953, and 15 per cent under the 1954 Code provision applicable to the taxable year 1954.[6]

If a miner does not conduct manufacturing operations, *i.e.,* if he does not "destroy the physical or chemical identity of the minerals or permit them to be transformed into new products," *United States* v. *Cannelton Sewer Pipe Co.,* 364 U.S. 76, 86, his "gross income from mining" is usually his actual gross receipts from the sales of the raw material. In the case of an integrated producer—one who does not sell the raw mineral he mines but uses it in his own manufacturing operations—"gross income from mining" is the producer's constructive income from the raw mineral product of his mining operations. See *ibid.*

[6] Section 114(b)(4)(A)(ii) of the 1939 Code; Section 613(b)(7) of the 1954 Code, Appendix D, *infra,* p. 14a.

The governing Treasury Regulations[7] provide two methods for determining the constructive "gross income from the mining" of an integrated miner-manufacturer. Under both methods the constructive figure is derived from actual sales data. If a representative price for the raw mineral is established by arm's-length sales in a relevant market—by the taxpayer or another miner—that price is the measuring-stick of constructive mining income for the raw mineral which the integrated producer uses in his own manufacturing operations. But if such a representative price cannot be established because the raw mineral is not generally sold on the open market—as in the integrated cement industry—then the producer's constructive mining income is derived under the proportionate profits method from his own sales price of his manufactured end product.

The objective of the proportionate profits method is to identify the portion of an integrated producer's gross sales that has been produced by the costs of his mining operations; that portion is the producer's constructive mining income. In substance the method, long established under the Treasury Regulations,[8] apportions gross sales receipts between mining and non-mining income in the same ratio as the producer's mining costs bear to its overall costs.

---

[7] The successive Regulations applicable to the taxable years involved are listed p. 4, n. 4, *supra*.

[8] The method was first prescribed under the 1939 Code in Treasury Regulations 103 (1940), Section 19.23(m)-1(f).

This apportionment is reflected in the following single equation:

$$\frac{\text{Mining costs}}{\text{Total costs}} \times \text{Gross sales of cement} = \text{Gross income from mining}$$

*Riddell* v. *California Portland Cement Co.*, 330 F. 2d 16 (C.A. 9); *Whitehall Cement Manufacturing Co.* v. *United States*, 369 F. 2d 468 (C.A. 3). The basic theory of the method is that every dollar of the producer's costs, mining and non-mining alike, is deemed to produce the same proportionate part of the profits earned through sales of the first marketable end product; and it is the gross receipts from such sales which are apportioned in accordance with the cost ratio. *Standard Lime and Cement Co.* v. *United States*, 329 F. 2d 939 (Ct. Cl.); *Whitehall Cement Manufacturing Co.* v. *United States, supra*; *United States* v. *Portland Cement Co. of Utah*, 378 F. 2d 91 (C.A. 10), certiorari denied, 389 U.S. 975. The premise that every dollar of costs produces the same ratable part of the profits is in accord with long-settled principles of corporate accounting. See Paton and Littleton, *An Introduction to Corporate Accounting Standards* (American Accounting Association, 1940), p. 67.

2. (a) The decision below to exclude post manufacturing costs from the proportionate profits computation is in conflict with the Court of Claims' decision in *Standard Lime and Cement Co.* v. *United States, supra,* and the Third Circuit's decision in *Whitehall Cement Manufacturing Co.* v. *United States, supra.* In *Standard Lime* the Court of Claims, stressing (329 F. 2d at 944) the basic theory of the method that "each dollar of costs expended to produce and sell

the end product earns the same percentage of the profit," assigned (*id.* at 945, n. 13) a proportionate part of the taxpayer's profits to its post-manufacturing costs of transporting and marketing its cement.[9] Similarly, in *Whitehall Cement,* the Third Circuit ruled that the taxpayer's post-manufacturing costs of bulk loading for shipment had to be treated as costs of non-mining activities.

Thus, *Whitehall Cement* and *Standard Lime and Cement* require that all non-mining costs be taken into account and that costs such as those in issue here, together with a proportionate part of the profits, be excluded from the depletable "gross income from mining."

(b) The decisions of the Court of Claims and the Third Circuit are correct, and the decision of the majority of the Tenth Circuit in this case is erroneous. No expense may be "eliminated" from or deemed "not a proper part" of the proportionate profits method, for the underlying accounting theory is abrogated unless a producer's gross sales are allocated in accordance with a cost fraction which includes in its denominator all of the costs producing the sales. The determination of the integrated miner-manufac-

[9] *Standard Lime* articulates the computational approaches in a different manner than *Whitehall*—but achieves the same end result, because the same basic theory was applied. *Standard Lime* reflects the literal description of the proportionate profits method in the 1939 Regulations applicable to the earlier taxable years here involved. Under that prescription non-mining costs *together with* their proportion of the profits are subtracted from gross sales. This manner of working back from gross sales maintains the proper correspondence between a constructive income figure and related costs as of any point in an integrated producer's operations.

turer's "gross income from mining", requires an allocation of all its income from sales of its end product between the mining and non-mining phases of the company's operations. *All* costs and *all* of the profit must be allocated to either the mining or the non-mining part of the operation. If an item of expense in fact results from the mining phase of the business, it should be included in the "gross income from mining", and also carry into "gross income from mining" its ratable share of the company's profit or loss. By the same token, every cost that is attributable to the non-mining operations, together with its allocable share of profit or loss, must be excluded from the depletion base. Otherwise the depletion allowance will not be restricted to its intended ambit, the return of the miner's capital interest in depleting minerals.[10]

In the case at bar, the majority of the court below did not recognize that *all* of the costs of producing cement had to be taken into account in determining the cost ratio. It correctly characterized as non-mining the substantial post-manufacturing costs, *i.e.*, those of bulk loading, bags and bagging, operating storage warehouses and distribution terminals, and the transportation thereto, as well as the costs incurred by respondent to advertise and to sell its cement. But it refused to apply the basic theory of the proportionate

[10] Recently adopted Treasury Regulations on Income Tax, Section 1.613–3(d)(1)(i), App. D, *infra*, explicitly provide—in keeping with *Standard Lime* and *Whitehall Cement*—that "each dollar of the total costs paid or incurred to produce, transport and sell the first marketable product or group of products earns the same percentage of the profit". These Regulations are applicable to the fourth taxable year (1954) involved in this litigation.

profits method to these costs, by excluding them from the denominator (total costs) of the cost fraction. This in effect puts part of the post-manufacturing costs and their allocable share of profits within respondent's depletion base, for it requires the allocation of *all* sales income by a ratio that includes only mining and manufacturing costs in the denominator. Thus it has done indirectly what the district court did directly: include non-mining costs and non-mining profit in respondent's "gross income from mining". As the dissenting judge observed below (App. A, *infra*, p. 8a), this "reaches a result that is a rejection of the basic theory of the proportionate profits method itself." So long as the majority decision stands, the proportionate profits method, as long established by Treasury Regulations and approved by other federal courts, will not be applied in the Tenth Circuit, and an integrated producer having his tax home there may have his constructive mining income and therefore his depletion improperly augmented.

3. The decision below that respondents' gross sales should be determined on the assumption that all its cement was sold in bulk[11] is in conflict with the decision of the Third Circuit in *Whitehall Cement*. In the Third Circuit, the taxpayer argued that the costs incident to and premiums charged for cement

---

[11] In the court below respondent, while urging in the alternative the result reached by the court, asserted that that result would decrease its depletion base. (See its brief in the court below at p. 24, n. *.) This is true, however, only if respondent prevails, as it did below, on the first question presented and if the bag premium is less than the pertinent packaging costs.

sold in bags should be excluded from the proportionate profits calculation, on the theory that the bagging costs were more than the premium so that those costs could not fairly be considered to have produced a proportionate share of the manufacturer's overall profits. The Third Circuit rejected this argument as resting on (369 F. 2d at 474) "an erroneous assumption that the packaging costs produced only the additional revenue derived from the premiums * * *. It seems reasonable to infer that the profits realized from the sale of packaged cement, and these were substantial, were attributable at least in part to the packaging costs." The court, therefore, held that the packaging costs must be included in the denominator of the proportionate profits equation as a non-mining cost and that the premiums should be included in gross sales.

There is no basis for the theory invoked by the majority opinion here.[12] It asserts that cement in bulk is the first marketable product, so that the bulk price should be the assumed price for all sales of cement. But the nature of the product depends on its physical and chemical characteristics. See *United States* v. *Cannelton Sewer Pipe Co., supra,* 364 U.S. at 85–86. Neither the quantities nor the packages in which it is sold, and which determine the per unit price, affect the nature of the product. The proportionate profits method requires an allocation of the actual gross

[12] The recently adopted Treasury Regulations on Income Tax, Section 1.613–3(d)(1)(iv), App. D, *infra*, provide that the "gross sales" of the first marketable product shall include sales both in bulk and in bags. This applies to the last year in issue here, 1954.

receipts received upon the sale of that product, and that must be determined, as it was in the Third Circuit, solely on the basis of the prices in fact charged for the commodity regardless of variations depending on such things as packaging.[13]

4. The ruling below that petitioner's expenses of processing purchased additives, in connection with preparing the kiln feed, are mining costs is in conflict with the rationale of the Court of Appeals for the Ninth Circuit in *Riddell* v. *California Portland Cement Co.*, 330 F. 2d 16.

That case holds that the costs of acquiring additives are non-mining costs. Here the question is slightly different in form, but the answer must be the same. The definition of mining in Section 613(c)(4) speaks of "treatment process * * * *applied* to the * * * mineral" that is the subject of depletion. In consequence,

[13] The decision below also appears to conflict with the reasoning in *Riddell* v. *Victorville Lime Rock Co.*, 292 F. 2d 427 (C.A. 9). That was not a proportionate profits case, but required a determination of whether the taxpayer-miner's gross income from mining should be computed on the basis of his sales of limestone in bulk or the higher [redacted] price charged for limestone sold in bags. In holding that (*id.* at 436) "[b]ags and bagging are not required in order to obtain the commercially marketable mineral product", and that the miner's depletion basis should not include "[i]ncome attributable to bags and bagging", the Ninth Circuit in substance ruled that the cost of bags and bagging and the resulting premiums were not attributable to the mining. The court's statement (*ibid.*) that "[b]ags and bagging was not required in order to obtain the commercially marketable mineral product", taken out of context, could be read as supporting the decision here. But it must be viewed as a definition of the end of mining, and not as a determination of the sales price to be used in a proportionate profits allocation.

a processing cost can be characterized as a mining cost only if it represents treatment of the mineral that is the subject of the particular proportionate profits computation. As stated in the preamble to Section 613(c)(4), App. D, *infra*:

> The following treatment processes where applied by the mine owner or operator shall be considered as mining *to the extent they are applied to the ore or mineral in respect of which he is entitled to a deduction for depletion under Section 611:* [Emphasis supplied.]

See, also, H. Conf. Rep. No. 2005, 86th Cong., 2d Sess., pp. 8–9.

Under these authorities, the decision of the Ninth Circuit in *California Portland Cement* is correct and the decision below is not. The decisive point, in the Ninth Circuit's language, is that there must be (330 F. 2d at 18) "separate computations of depletion of component minerals." If either the cost of acquiring additives or the cost of processing them could be added to the cement manufacturer's mining costs, he would be obtaining a depletion allowance with respect to the additive over and above that available upon the mining of that additive. Therefore, each mineral component of the kiln feed may be depleted only by the taxpayer who mined it, and only in the manner applicable to that mineral. Rev. Rul. 290, 1953–2 Cum. Bull. 41. The miner and seller of the additives in issue here had the right to deplete them, and a buyer such as respondent plainly does not.

5. The conflicts between the decision here and those of the Court of Claims and the Third and Ninth

Circuits is a matter of substantial importance in the administration of federal revenue laws. The most direct impact is on miner-manufacturers of portland cement, who have tax homes throughout the nation and manufacture the most widely used construction material.[14] Thus even within this one industry, the issues of this case are of substantial nationwide significance.

The importance of these questions, moreover, extends beyond this one market place, for they will generally arise whenever the proportionate profits method is used. It will apply to miner-manufacturers of light-weight aggregate, brick, tile, and other vitreous products. We are advised, moreover, that the Internal Revenue Service has in some circumstances found it necessary to use the proportionate profits method in the case of iron ore, coal, limestone, bauxite, crushed and broken stone, and lignite.[15] The post-manufacturing costs involved here are, for tax purposes, indistinguishable from the costs of storage, distribution, and marketing incurred by any other

---

[14] The portland cement industry in 1963 comprised some two score companies having 181 producing plants in 40 states and Puerto Rico with a total production capacity of 478 million barrels. See *Mineral Facts and Problems*, Bureau of Mines Bulletin 630 (1965 ed.), p. 189.

[15] The extent of the potential difficulties in industries other than portland cement, may be demonstrated by the fact that in 1953 50.2 million tons of clay, valued at $181,000,000, were produced from 1,300 mines by about 1,000 firms, for use in manufacturing building brick and tile, sewer pipe, terra cotta, lightweight aggregates and refractory products. About 97 percent of the miscellaneous clay and 70 percent of the fire clay was extracted from mines owned or controlled by integrated producers. *Id.* at 228.

integrated miner-manufacturer, whatever the mineral he mines and the end product he ultimately sells. The same may be said of the problems of determining the appropriate treatment of the cost of bags and bagging, for it is common throughout industry for one commodity to be sold in different quantities at different per unit prices as well as with different packaging. And the problem of the proper treatment of additives and the costs of processing them also occurs with frequency, since there are a variety of minerals the mining of which is defined in Section 613(c) to include processes that may result in the addition of other depletable materials.

There are currently 22 proportionate profits cases being litigated in various courts, involving in excess of $6,000,000. Many of these cases involve, as does the instant case, taxable years in the early 1950's. The taxpayers' subsequent years are open on refund claims awaiting the outcome of litigation, so that many millions more in revenue are in fact involved.[16]

The tax liabilities of miner-manufacturers in integrated industries may be determined in an orderly and uniform fashion only if this Court resolves the conflict that has arisen among the lower federal courts.

---

[16] The amount involved in controversies pending at the administrative level is not susceptible of present evaluation.

## CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted.

ERWIN N. GRISWOLD,
*Solicitor General.*
JOHNNIE M. WALTERS,
*Assistant Attorney General.*
HARRIS WEINSTEIN,
*Assistant to the Solicitor General.*
GRANT W. WIPRUD,
*Attorney.*

APRIL 1969.

# APPENDIX A

United States Court of Appeals

Tenth Circuit

July Term 1968

No. 9571

UNITED STATES OF AMERICA, APPELLANT

*v.*

IDEAL BASIC INDUSTRIES, INC., APPELLEE

*Appeal From the United States District Court for the District of Colorado, Civil No. 6384*

Before MARVIN JONES,* LEWIS and HICKEY, Circuit Judges

HICKEY, *Circuit Judge.*

Appellee, Ideal Basic Industries, Inc., for itself and its merged affiliate, Pacific Portland Cement Co., sues for refund of income and excess profit taxes paid for the years 1951 through 1954. The trial court granted the refund claimed by appellee. The government appeals. Jurisdiction is conferred by 28 U.S.C. § 1291.

The appeal presents two questions: (1) Are taxpayer's claims for the years 1951, 1952, and 1954 with respect to the Ada, Oklahoma, plant barred by failure to present a claim for refund within the period of

* Senior Judge, United States Court of Claims, sitting by designation.

limitations? (2) Is the determination of "Gross Income from Mining" properly made under the proportionate profits method of computation when certain costs are introduced into the proportionate fraction? The specific costs to be considered are:

1. Cost of processing additives.
2. Cost of bags and bagging.
3. Cost of bulk loading.
4. Cost of operating storage warehouses, distribution terminals, and the transportation thereto.
5. Costs of advertising, promoting and selling cement.

The facts are not in dispute. Appellee is an integrated miner-manufacturer. The first market price available is for the finished product, bulk cement, therefore, depletion is computed on the hypothetically derived value of "kiln feed." 26 U.S.C. § 613(c)(4)(F). Appellee made timely election to use the proportionate profits formula to compute its "Gross Income from Mining" which would be subject to depletion.

We consider initially the procedural question relative to the period of limitations provisions.

All refund claims were initially filed on time, and all except the Ada, Oklahoma, claims were based upon the depletion percentage for limestone. In its 1951–53 returns, appellee claimed the calcareous material at Ada was calcium carbonate, depletable at 10%. In its 1954 return, appellee claimed the argillaceous material at Ada was shale, depletable at 5%. Later the appellee amended its 1951–53 claims relating to Ada, Oklahoma, to identify the calcareous material as chemical grade limestone, depletable at 15%. The 1954 claim was amended to identify the argillaceous material as clay, depletable at 15%. The commissioner denied the amended claims for 1951, 1952, and 1954 on

the ground they were filed out-of-time. The trial court reversed and allowed the amended claims.

The test applied to determine, "[w]hether a new ground of recovery may be introduced after the statute has run by amending a pending claim filed in time depends upon the facts which an investigation of the original claim would disclose. Where the facts upon which the amendment is based would necessarily have been ascertained by the commissioner in determining the merits of the original claim, the amendment is proper." *Pink* v. *United States,* 105 F. 2d 183, 187 (2d Cir. 1939). (citations omitted). "The test is one which affords the government ample protection against the filing of stale claims * * * while at the same time providing no arbitrary limit on the amendment of claims previously filed." *St. Joseph Lead Co.* v. *United States,* 299 F. 2d 348, 350 (2d Cir. 1962). (citations omitted).

The trial court found the contested mineral identification issues in favor of the taxpayer. When the initial claim was filed it was incumbent upon the commissioner to identify the minerals upon which depletion was claimed. The findings clearly indicated the identity of the minerals as limestone and clay, entitled to the 15% depletion rate. Therefore, the commissioner could not have been misled nor did the amendment introduce a new ground for recovery.

" 'If the Commissioner is not deceived or misled by the failure to describe accurately the claim, as obviously he was not here, it may be more convenient for the government and decidedly in the interest of an orderly administrative procedure that the claim should be disposed of upon its merits.' " *Reynold* v. *McMurray,* 77 F. 2d 740, 744 (10th Cir. 1935), quoting *Tucker* v. *Alexander,* 275 U.S. 228, 231 (1927).

We now turn to the question which involves the merits of the controversy.

This circuit has adopted the proportionate profits method for determining the "Gross Income from Mining" for the purpose of depletion in the miner-manufacturer product, cement. *United States* v. *Portland Cement Co.*, 378 F. 2d 91, 93 (10th Cir. 1967).

$$\text{Gross Income from Mining} = \frac{\text{Mining Cost}}{\text{Total cost of [bulk] cement}} \times \text{Sales price of first marketable product, i.e., [bulk] cement.}^{1}$$

"This method works back to the end result by reducing the representative market or field price of the taxpayer's first marketable product by his non-mining costs plus the proportionate profits allocable to his non-mining activity. For this purpose profits are allocated between mining and non-mining activities in the proportion that the taxpayer's non-mining costs bear to his total costs." Hamovit, Depletion for the Integrated Miner-Manufacturer, 13 Rocky Mtn. Mineral L. Inst. 411, 422 (1967).

The trial court found: "The grinding and blending of prekiln additives was incidental to the grinding and blending of plaintiff's own materials." *Ideal Cement Co.* v. *United States*, 263 F. Supp. 594, 601 (D. Colo. 1966). We agree, therefore, we would not

[1] The numerator, mining costs, is the cost of the process including applicable overhead up to and including kiln feed. The denominator, total cost of bulk cement, is the cost of the bulk cement, or stated another way, the total cost of mining and non-mining activities including the overhead and administrative cost attributable to mining and non-mining activities. The multiplier, sales price of first marketable product, is the sales price of bulk cement. It may be helpful to note that the sales price of the first marketable product is to be computed on the identical physical material that is represented by total mining and non-mining costs.

deduct the costs from the numerator (mining costs) in the proportionate formula. Other courts have so held. *Whitehall Cement Mfg. Co.* v. *United States,* 237 F. Supp. 838 (E.D. Pa.), *modified,* 242 F. Supp. 326 (E.D. Pa. 1965), *aff'd without discussion of this issue,* 369 F. 2d 468 (3d Cir. 1966); *Riddell* v. *California Portland Cement Co.,* 330 F. 2d 16 (9th Cir. 1964).

We conclude that "first marketable product" is the proper sales price to which the application of the formula was intended, therefore, the costs of bags, bagging, and bulk loading should be eliminated from all parts in the formula. "Consequently we must hold that those packing and loading costs are indirect costs which are not incurred for the benefit of the entire operation and as such *cannot be included in taxpayer's computation of gross income* from the property at kiln feed." *Standard Lime & Cement Co.* v. *United States,* 329 F. 2d 939, 948 (Ct. Cl. 1964) (emphasis added); *accord, United Salt Corp.,* 40 T.C. 359 (1963). Equally compelling is the simple logic that bulk cement is the first marketable product,[2] bagged cement is the second marketable product, as for example "sakrete"[3] would be a third marketable product.

The cost of operating storage warehouses, distribu-

[2] Bulk cement is the first marketable product because it *can* be sold. The Supreme Court, in *United States* v. *Cannelton Sewer Pipe Co.,* 364 U.S. 76 (1960), held that a sale only needed to be possible. Certainly bulk cement is saleable. Only the details of the manner of loading and whether the buyer or seller bears the loading costs need be resolved. The fact is that bulk cement is marketable. In addition there is no earlier point in the manufacturing procedure where the "goods in process" can be sold.

[3] "Sakrete" is a bagged mixture of cement, sand, and gravel to which water may be added to make concrete.

tion terminals, and the transportation thereto are, on their face, non-mining and non-processing costs. The basic principle concerned is to allow a deduction to compensate for the depleting resource and, therefore, the formula is oriented to the value of the resource at the time of its extraction rather than to the ultimate sale price of the manufactured product. Transportation, governed by regulated rates, does not add to or detract from the appellant's profit as computed for bulk cement and is not a proper part of the "Gross Income from Mining" computation. The operation of warehouses and of distribution terminals are marketing facilities for the manufactured product and are, therefore, cost oriented to the value of the manufactured product rather than the value of the depleted resource. Both should be eliminated from the formula to arrive at the gross resource income. *Standard Lime & Cement Co.* v. *United States,* 329 F. 2d 939 (Ct. Cl. 1964). *See Commissioner* v. *American Gilsonite Co.,* 259 F. 2d 654, 657 (10th Cir. 1958).

The advertising, promotional, and selling costs are not a proper part of the computation. These costs, like bagging (packing) and loading costs are overhead charges properly applicable to finished cement after it has become "first marketable product." The selling, advertising, promotional, loading, bagging, and transportation costs are all distribution costs to get the finished cement from the point of completed manufacture to the next user. A hypothetical model to test this point would be the case of a cement block manufacturer with facilities adjacent to the cement plant.

If the block manufacturer utilized all of the output of the cement plant, then there would not be any necessity for the cement manufacturer to incur costs of distribution. The cement manufacturer would not

incur selling, advertising, promotional, loading, bagging, or transportation expenses. "We are of the opinion that all of taxpayer's * * * costs are distribution expenses which cannot be allocated by taxpayer in its computation of gross income from the property at kiln feed." *Standard Lime & Cement Co.* v. *United States,* 329 F. 2d 939, 948 (Ct. Cl. 1964). The assumption of the proportionate profits formula is that in the absence of a market price for the mined product, i.e., chemical grade limestone, an artificial price for "kiln feed" must be computed. The artificial price is predicated upon a real price which is determined in a hypothetically free market place. The intent is to establish this real market price as near the mine as possible, therefore, the liturgy of "first marketable product." First marketable product means the cost of bulk cement, and that means the cost of mining plus the cost of processing to the point that the bulk cement is delivered to the silo from the final milling, plus those overhead items which may be fairly attributable to mining and processing. Overhead amounts dealing with sales cannot be logically attributed to mining as the government points out. Likewise, these items of overhead are equally inapplicable to the process from the "kiln feed" point to the silo. The logic of this approach is, the closer to the mine that the mining costs, the cost of bulk cement, and the free market price can be established, the smaller the possibility of distortion of the depletion figure, and the fairer the result for the taxpayer and the government.

The fallacy of the appellee's argument that the teaching of *United States* v. *Cannelton Sewer Pipe Co.,* 364 U.S. 76 (1960), is parity among miners is that the hypothetical sales expense of a limestone mine selling to a cement manufacturer is a different

fact situation from a cement manufacturer selling to a wide variety of end users. The appellee is seeking hypothetical equality between a miner and an economically distinct entity, a manufacturer. Under *Cannelton* the appellee is, in fact, entitled to include any sales expense he can demonstrate which can be attributed to the cost incurred by his mining operation in selling kiln feed to his processing, or manufacturing operation.

We therefore affirm in part and reverse in part and remand to the trial court for computation in conformance with this opinion.

*Remanded.*

LEWIS, *Circuit Judge,* dissenting.

I must dissent for it appears to me that the reasoning of the majority, abandoning as it does both the views of the trial court and the arguments of the parties, reaches a result that is a rejection of the basic theory of the proportionate profit method itself. The method, by relating gross sales proportionately to mining costs and total costs, purports to isolate for tax purposes income from mining from that attributable to non-mining activity. The basic equation is:

$$\frac{\text{mining costs}}{\text{total costs}} \times \text{gross sales} = \text{gross income from mining}$$

The formula is cost-oriented and assumes the premise that each dollar of cost is reflected proportionately in profit. This premise is, of course, one of convenience and practical necessity but artificial and thus lends itself to easy attack when specific items of cost are allocated to or excluded from the formula. Common sense dictates that if unproductive costs so corrupt the formula as to patently distort the reality of result such costs should be eliminated from the equa-

tion. *United States* v. *Portland Cement Co. of Utah*, 10 Cir., 378 F. 2d 91, 92–93. But elimination of a specific element of cost must be the exception for the proportionate profit method assumes that every item of cost, directly attributable to mining or not, is incurred for the benefit of the integrated business and must therefore be reflected in both cost and gross sales if the equation is to be acceptable.

The trial court held that Ideal's first marketable product was cement, whether sold in bulk or in bags, and allocated the element of bag expense within the cost fraction as a balance to the inclusion of such cost in total sales. Since the actuality of this particular company's selling practice shows that bagging amounts to but a premium charge there may be justification for this view although I would agree with the United States that the cost of bagging, in general, is a non-mining cost. The main opinion, however, rejects the finding that cement is Ideal's first marketable product, finds that bulk cement is such product, and then eliminates the cost of bagging completely from the equation. I would include such cost under either finding for certain it is that the quantity of bulk cement sold is increased by bagging and its contribution to gross sales thus actually exceeds the simple premium cost of bags.

As I have indicated, I can see some separate merit to the arguments of the parties that the cost of bagging should be included only in the denominator of the subject fraction (as argued by the United States), allocated between the numerator and denominator as the trial court determined (as supported by the argument of the appellee) or even eliminated from the equation because of the premium nature of the item to this particular company's cost (as advanced as an

alternative position by appellee). And these contentions of the parties have been projected in support of or as an attack upon the judgment of the trial court whose decision treated each other item (such as transportation, warehousing, distribution and selling costs, etc.) with particularity and, with some exceptions, allocated a portion of these costs to mining. Since the main opinion with a broad sweep apparently eliminates all these costs and expenses from inclusion within the formula it would serve no present purpose to express my agreement or disagreement with those aspects of the judgment below. It is sufficient to note that neither the United States nor the taxpayer has made any suggestion that consideration of these items is not proper within the bounds of the proportionate profit method. Their disagreement lies with where and how such costs should be placed within the equation. I consider that to be the issue presented to us and inherent in the application of the proportionate profit method. To eliminate all post-manufacturing costs destroys consideration of the representative market or field price of the first marketable product, a prime factor in the application of the equation, and thus seems to me to reject the method itself.

I agree that taxpayer's claim is not barred by limitation.

Dated August 15, 1968.

## APPENDIX B

July Term, Thursday, August 15, 1968

UNITED STATES OF AMERICA, APPELLANT

*vs.*

IDEAL BASIC INDUSTRIES, INC., APPELLEE

*Appeal From the United States District Court for the District of Colorado*

No. 9571

Before Honorable MARVIN JONES, Judge, United States Court of Claims, and Honorable DAVID T. LEWIS and Honorable JOHN J. HICKEY, Circuit Judges

This cause came on to be heard on the transcript of the record from the United States District Court for the District of Colorado and was argued by counsel.

On consideration whereof, it is ordered and adjudged by this court that the judgment of the said district court in this cause is affirmed in part and reversed in part, and the cause remanded to the trial court for computation in conformance with the opinion of the court.

Honorable DAVID T. LEWIS, *Circuit Judge,* dissented.

Dated August 15, 1968.

# APPENDIX C

January Term, January 20, 1969

No. 9571

UNITED STATES OF AMERICA, APPELLANT

*vs.*

IDEAL BASIC INDUSTRIES, INC., APPELLEE

*Appeal From the United States District Court for the District of Colorado*

Before Honorable ALFRED P. MURRAH, Chief Judge, and Honorable DAVID T. LEWIS, Honorable JEAN S. BREITENSTEIN, Honorable DELMAS C. HILL, Honorable OLIVER SETH, Honorable JOHN J. HICKEY and Honorable WILLIAM J. HOLLOWAY, Jr., Circuit Judges

This cause came on to be heard on the petition of appellant for a rehearing herein en banc and was submitted to the court.

On consideration whereof, it is ordered by the court that the said petition for rehearing en banc be and the same is hereby denied.

Honorable DAVID T. LEWIS and Honorable WILLIAM J. HOLLOWAY, Jr., voted for rehearing en banc.

# APPENDIX D

Internal Revenue Code of 1954:

SEC. 611.[1] ALLOWANCE OF DEDUCTION FOR DEPLETION.

(a) *General Rule.*—In the case of mines, oil and gas wells, other natural deposits, and timber, there shall be allowed as a deduction in computing taxable income a reasonable allowance for depletion and for depreciation of improvements, according to the peculiar conditions in each case; such reasonable allowance in all cases to be made under regulations prescribed by the Secretary or his delegate. * * *

* * * * *

[26 U.S.C. 611.]

SEC. 613.[2] PERCENTAGE DEPLETION.

(a) *General Rule.*—In the case of the mines, wells, and other natural deposits listed in subsection (b), the allowance for depletion under section 611 shall be the percentage, specified in subsection (b), of the gross income from the property * * *.

---

[1] Section 23(m) of the Internal Revenue Code of 1939, applicable for taxable years beginning before December 31, 1953, is substantially the same as Section 611(a) of the Internal Revenue Code of 1954.

[2] Section 114(b)(3) and (4) of the Internal Revenue Code of 1939, as amended by Section 145, Revenue Act of 1942, c. 619, 56 Stat. 798; Section 124, Revenue Act of 1943, c. 63, 58 Stat. 21; Section 207, Revenue Act of 1950, c. 994, 64 Stat. 906; and Section 319, Revenue Act of 1951, c. 521, 65 Stat. 452, applicable for taxable years beginning before December 31, 1953, is substantially the same as Section 613 of the Internal Revenue Code of 1954, as originally enacted. Section 613(c)(2) and (4) are set forth below as amended by Section 302(b) of the Public

(b) *Percentage Depletion Rates.*—The mines, wells, and other natural deposits, and the percentages, referred to in subsection (a) are as follows:

* * * * *

(7) 15 percent—all other minerals (including but not limited to * * * limestone * * *), except that * * *

* * * * *

(c) *Definition of Gross Income from Property.*—For purposes of this section—

(1) *Gross income from the property.*—The term "gross income from the property" means, in the case of a property other than an oil or gas well, the gross income from mining.

(2) *Mining.*—The term "mining" includes not merely the extraction of the ores or minerals from the ground but also the treatment processes considered as mining described in paragraph (4) (and the treatment processes necessary or incidental thereto), and so much of the transportation of ores or minerals (whether or not by common carrier) from the point of extraction from the ground to the plants or mills in which such treatment processes are applied thereto as is not in excess of 50 miles unless the Secretary or his delegate finds that the physical and other requirements are such that the ore or mineral must be transported a greater distance to such plants or mills.

* * * * *

(4) *Treatment Processes Consideerd as Mining.*—The following treatment processes where applied by the mine owner or operator

---

Debt and Tax Rate Extension Act of 1960, P.L. 86-564, 74 Stat. 290, since these amended definitions of mining were applicable to the taxable years involved by reason of respondent's election, as set forth in the text.

shall be considered as mining to the extent they are applied to the ore or mineral in respect of which he is entitled to a deduction for depletion under section 611:

* * * * *

(F) in the case of calcium carbonates and other minerals when used in making cement—all processes (other than preheating of the kiln feed) applied prior to the introduction of the kiln feed into the kiln, but not including any subsequent process;

* * * * *

[26 U.S.C. 613.]

Treasury Regulations 118 (1939 Code):

Sec. 39.23(m)–1. *Depletion of mines, oil and gas wells, other natural deposits, and timber; depreciation of improvements.*

* * * * *

(e) As used in sections 114(b)(3) and 114(b)(4)(A) and sections 39.23(m)–1 to 39.23(m)–19, inclusive, the term "gross income from the property" means the following:

* * * * *

(3) If the taxpayer sells the crude mineral product of the property in the immediate vicinity of the mine, "gross income from the property" means the amount for which such product was sold, but, if the product is transported or processed (other than by the ordinary treatment processes described below) before sale, "gross income from the property" means the representative market or field price (as of the date of sale) of a mineral product of like kind and grade as beneficiated by the ordinary treatment processes actually applied, before transportation of such product (other than transportation treated, for the taxable year, as mining). If there is no such represent-

ative market or field price (as of the date of sale), then there shall be used in lieu thereof the representative market or field price of the first marketable product resulting from any process or processes (or, if the product in its crude mineral state is merely transported the price for which sold) minus the costs and proportionate profits attributable to the transportation (other than transportation treated, for the taxable year, as mining) and the processes beyond the ordinary treatment processes. If the taxpayer establishes to the satisfaction of the Commissioner that another method of computation, other than the computation of profits proportionate to costs, clearly reflects the gross income from the property, then such gross income shall be computed by the use of such other method.

* * * * *

Treasury Regulations on Income Tax (1954 Code):[3]

Sec. 1.613–3. *Gross income from the property.*

* * * * *

(d) *Sales after the application of non-mining processes where a representative market or field price cannot be ascertained*—(1) *Computation of gross income from the property by use of the proportionate profits method.* (i) If it is impossible to determine a representative market or field price as described in paragraph (c) of this section, then, except as provided in subparagraph (2) of this paragraph, gross income from the property shall be computed by use of the proportionate profits method. See § 1.611–0. The objective of the proportionate profits method of computation is to ascertain

[3] The provisions set forth in the text were published in the Federal Register on July 26, 1968, as T.D. 6965, 33 F.R. 10692, and are applicable to taxable years beginning after December 31, 1953.

gross income from the property by applying the principle that each dollar of the total costs paid or incurred to produce, transport and sell the first marketable product or group of products earns the same percentage of profit. Accordingly, in the proportionate profits method no ranking of costs is permissible which results in excluding or minimizing the effect of any costs incurred to produce, sell and transport the first marketable product or group of products. See subdivision (iv) of this subparagraph for the definition of the term "first marketable product or group of products".

(ii) The proportionate profits method of computation is applied by multiplying the taxpayer's gross sales (actual or constructive) of his first marketable product or group of products (after making the adjustments required by paragraph (e) of this section) by a fraction whose numerator is the sum of all the costs allocable to those mining processes which are applied to produce, sell, and transport the first marketable product or group of products, and whose denominator is the total of all the mining and nonmining costs paid or incurred to produce, sell, and transport the first marketable product or group of products (after making the adjustments required by this paragraph and paragraph (e) of this section). See subdivision (iv) and (v) of this subparagraph for the definitions of the terms "first marketable product or group of products" and "gross sales (actual or constructive)", respectively. The method as described herein is merely a restatement of the method formerly set forth in the second sentence of Regulations 118, § 39.23(M)–1(e)(3) (1939 Code). The proportionate profits method of computation may be illustrated by the following equation:

$$\frac{\text{Mining costs}}{\text{Total costs}} \times \text{gross sales} = \text{Gross income from mining}$$

* * * * *

(iv) As used in this section, the term "first marketable product or group of products" means the product (or group of essentially the same products) produced by the taxpayer as a result of the application of nonmining processes, in the form or condition in which such product or products are first marketed in significant quantities by the taxpayer or by others in the taxpayer's marketing area. For this purpose, bulk and packaged products are considered to be essentially the same product. The first marketable product or group of products does not include a product or group of products additionally refined, beneficiated, altered, or manufactured as a result of the application of additional nonmining processes. For example, if a cement manufacturer sells his own finished cement of various types in bulk and bags and also sells concrete blocks or dry ready-mix aggregates containing additives, the finished cement of various types, in bulk and bags, constitutes the first marketable product or group of products produced by him. * * *.

* * * * *

(4) *Treatment of particular items in computing gross income from the property by use of the proportionate profits method or another approved method based on the taxpayer's costs.* (i) Except as specifically provided elsewhere in this section, when determining gross income from the property by use of the proportionate profits method or any other approved method which is based on the taxpayer's costs, the costs attributable to mining transportation shall be treated as mining costs, and the costs attributable to nonmining transportation shall be treated as nonmining costs. * * *

(ii) In determining gross income from the property by use of the proportionate profits method or any other approved method which

is based on the taxpayer's costs, a process shall not be considered as a mining process to the extent it is applied to ores, minerals, or other materials with respect to which the taxpayer is not entitled to a deduction for depletion under section 611. The costs of such nondepletable ores, minerals, or materials; the costs of the processes (including blending, size reduction, etc.) applied thereto; and the transportation costs thereof, if any, shall be considered as nonmining costs in determining gross income from mining. If a mining process is applied to an admixture of depletable and nondepletable material, the cost of the process and the cost of transportation, if any, attributable to the nondepletable material shall be considered as nonmining costs in determining gross income from mining. Accordingly, all profits attributable thereto are treated as nonmining profits. In the absence of methods which will more clearly reflect the cost attributable to the processing and transportation, if any, of the nondepletable admixed material, the cost attributable thereto shall be deemed to be that proportion of the costs which the tonnage of nondepletable material bears to the total tonnage of both depletable and nondepletable material.

(iii) In determining gross income from the property by use of the proportionate profits method (or any other approved method which is based on the taxpayer's costs)—

(*a*) The costs attributable to containers, bags, packages, pallets, and similar items as well as the costs of materials and labor attributable to bagging, packaging, palletizing, or similar operations shall be considered as nonmining costs.

(*b*) The costs attributable to the bulk loading of manufactured products shall be considered as nonmining costs.

(*c*) The costs attributable to the operation of warehouses or distribution terminals for

manufactured products shall be considered as nonmining costs. Accordingly, all profits attributable thereto are treated as nonmining profits.

(iv) In computing gross income from the property by means of the proportionate profits method or any other approved method based on the taxpayer's costs, the principles set forth in paragraph (c) of § 1.613–4 shall apply when determining whether selling expenses and trade association dues are to be treated, in whole or in part, as mining costs or as nonmining costs. To the extent that selling expenses and trade association dues are treated as nonmining costs, all profits attributable thereto are treated as nonmining profits.

* * * * *

[33 F.R. 10692; 26 C.F.R. 1.613–3.]

U.S. GOVERNMENT PRINTING OFFICE: 1969

[redacted]

# Supreme Court of the United States

October Term, 1968

No. 1379

UNITED STATES OF AMERICA, Petitioner

v.

IDEAL BASIC INDUSTRIES, INC.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE TENTH CIRCUIT

BRIEF FOR RESPONDENT IN OPPOSITION

[redacted]

OF COUNSEL:
CLAUDE M. MAER, JR.
[redacted]
Denver, Colorado 80202
HARRY R. HORROW
STEPHEN J. MARTIN
[redacted]
San Francisco, California 94104

[redacted]

## INDEX


| | Page |
|---|---|
| Opinions Below | 1 |
| Questions Presented | 1 |
| Summary | 3 |
| Statutes and Regulations Involved | 3 |
| Reasons Why the Writ Should Be Denied | 4 |
| Conclusion | 7 |


## CITATIONS


| | |
|---|---|
| Cases: | |
| *Riddell v. California Portland Cement Company*, 330 F.2d 16 (9th Cir. 1964) | 5, 6 |
| *Standard Lime & Cement Company v. United States*, 329 F.2d 939 (Ct. Cl. 1964) | 5 |
| *United States v. Ideal Basic Industries, Inc.*, 404 F.2d 122 (10th Cir. 1968) | 5 |
| *United States v. Portland Cement Co. of Utah*, 378 F.2d 91 (10th Cir. 1968) | 5 |
| *Whitehall Cement Manufacturing Company v. United States*, 369 F.2d 468 (3d Cir. 1966) | 5 |
| Statutes: | |
| Act of September 14, 1960, P.L. 86-781, 74 Stat. 1017 | 2 |
| Internal Revenue Code of 1939: | |
| § 23(m) | 1 |
| § 114(b) | 1 |
| Internal Revenue Code of 1954: | |
| § 611 | 1 |
| § 613 | 1 |
| § 613(c)(2) | 6 |
| § 7807(a) | 3 |
| Miscellaneous: | |
| Treasury Regulations 118, § 39.23(m)-1(e)(3) | 5 |
| Treasury Regulations on Income Tax, § 1.613-3(d) | 3 |
| T. D. 6091 (C.B. 1954-2, 47) | 3, 5 |

# Supreme Court of the United States

October Term, 1968

**No. 1279**

UNITED STATES OF AMERICA, Petitioner

v.

IDEAL BASIC INDUSTRIES, INC.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE TENTH CIRCUIT

## BRIEF FOR RESPONDENT IN OPPOSITION

### OPINIONS BELOW

The findings of fact and conclusions of law of the United States District Court for the District of Wyoming (R. 64-77)[1] are reported at 263 F. Supp. 594.

### QUESTIONS PRESENTED

This case involves the determination of the allowable depletion deduction to respondent, a producer of portland cement, for the taxable years 1951 through 1954.[2] The de-

[1]"R." references are to the Appendix in the Court of Appeals. "Pet." refers to the government's Petition for a Writ of Certiorari. "Pet. App." refers to Appendices to the Petition.

[2]Applicable statutes: 1951-53, §§ 23(m) and 114(b), Internal Revenue Code of 1939; 1954, §§ 611 and 613, Internal Revenue Code of 1954.

duction is based in turn on respondent's "gross income from mining" at the "kiln feed" cutoff point.[3] The parties are agreed that there is no representative market or field price for kiln feed since it is not sold in commerce, and, therefore, respondent's gross income from mining should be computed under the proportionate profits method by deriving constructively such gross income from the representative market or field price of respondent's first marketable product.

Thus, there is no dispute as to the applicable statutes nor the technique to be employed in arriving at the measure of respondent's depletable income. The questions presented here are limited solely to applying the proportionate profits method in computing respondent's gross income from mining and to factual and accounting problems as to the proper allocation of certain costs and expenses incurred by the respondent in its business.

1. Did the court below properly determine that the gross income from mining should be determined by allocating to mining a part of respondent's gross income from its first marketable product, bulk cement, in the proportion which the costs incurred to produce kiln feed bears to the costs incurred to produce bulk cement?[4]

2. Did the court below properly determine that respondent's first marketable product was bulk cement, or should the court have held that the respondent's first marketable product included cement placed in bags which was sold at a higher price.

---

[3]Respondent elected to compute its gross income from mining at the kiln feed cutoff point pursuant to § 4 of the Act of September 14, 1960 (P. L. 86-781, 74 Stat. 1017).

[4]As petitioner concedes (Pet. p. 6), the decision of the Court of Appeals below reached essentially the same "arithmetic result" as that of the District Court.

3. Did the court below properly affirm the trial court's finding of fact that the grinding and blending of relatively insignificant quantities of purchased pre-kiln additives was incidental to the grinding and blending of respondent's mined minerals.

## SUMMARY

From the above, it should be observed that the questions presented on which the government seeks review by this Court are essentially factual problems in the allocation of various costs and expenses incurred by this particular taxpayer in the production, marketing and distribution of cement.

## STATUTES AND REGULATIONS INVOLVED

The petitioner is in error in stating that Regulations § 1.613-3(d) are applicable to the year 1954 (Pet. pp. 5 and 13). The 1939 Code regulations prescribing the proportionate profits method (Pet. App. p. 15a) were specifically continued in effect under the 1954 Code until superseded by new regulations.[5] The 1954 Code regulations relied on by the government (Pet. App. pp. 16a-20a) differ in many material respects from the 1939 Code regulations. The 1954 Code regulations were not adopted until July 25, 1968, long after this case was tried, and in fact, many years after this case was first in controversy. Petitioner correctly states that it was undisputed between the parties at trial that respondent's gross income from mining should be determined under the proportionate profits method (Pet. p. 4). However, the proportionate profits method agreed upon by the parties was that set out in the regulations in effect at the time of trial, i.e. the 1939 Code regulations, and not the different method described in the regulations adopted in 1968.

---

[5] § 7807(a), 1954 Code; T.D. 6091 (C.B. 1954-2, 47).

## REASONS WHY THE WRIT SHOULD BE DENIED

1. *The Ruling Below Is Not A Matter of General Importance in the Administration of Federal Revenue Laws.*

Respondent is an integrated miner-manufacturer engaged, in the taxable years in question, solely in the production of portland cement. Respondent's nonproducing costs are incurred only with respect to the continuous series of processes beginning at the mine and ending with the production of the first marketable product, bulk cement. Therefore, the nonproducing costs involved here are different in kind from those incurred by other taxpayers who do not exclusively sell one mined-manufactured product such as portland cement and who might be required to allocate such costs among several products.

The technique of applying the proportionate profits method concerns itself essentially with the determination of the factual relationships between the various processes and activities involved in the production and distribution of the first marketable product. The court below was only concerned with the application of the proportionate profits method in the case of this taxpayer, a single product producer of cement, *(Ideal,* 404 F.2d at p. 125) and did not purport to lay down principles of general application to producers in other industries. There is a drastic diversity in the allocation problems that arise when the proportionate profits method is applied in different industries and to multi-product producers. This case does not present an appropriate occasion for this Court to promulgate meaningful broad standards that can govern the varied factual determinations by lower courts that arise at different contexts each with its own peculiar considerations.

2. *There Is No Conflict on Important Questions of Law Among the Appellate Courts.*

The rulings below do not conflict with the appellate

decisions relied on by petitioner. All of the appellate courts recognize that the objective is to determine a hypothetical gross income from the hypothetical sale of kiln feed for the purpose of computing an integrated miner-manufacturer's gross income from mining (*Standard Lime & Cement Company v. United States,* 329 F.2d 939, 946 (Ct. Cl. 1964); *Whitehall Cement Manufacturing Company v. United States,* 369 F.2d 468, 471 (3d Cir. 1966); *United States v. Ideal Basic Industries, Inc.,* 404 F.2d 122, 125 (10th Cir. 1968); *Riddell v. California Portland Cement Company,* 330 F.2d 16, 17 (9th Cir. 1964)). All courts agree that this determination is to be made by application of the proportionate profits method as described in Treas. Reg. 118,[6] § 39.23(m)-1(e)(3) made applicable to taxable years under the 1954 Code by T.D. 6091 (C.B. 1954-2, 47) (*Standard Lime, supra,* at p. 941, n. 3; *Whitehall Cement, supra,* at p. 471; *United States v. Portland Cement Co. of Utah,* 378 F.2d 91, 93 (10th Cir. 1968); *Ideal Basic Industries, Inc., supra,* at p. 125; *California Portland, supra,* at p. 17).

In essence the courts are in agreement as to the objective and the legal principles governing the determination of the questions presented. It is hardly appropriate for this Court to become involved in the details of the computation where the appellate courts are in agreement as to the objective to be achieved and the technique to be used.

It is not disputed that the starting point of the proportionate profits computation is the representative market or field price of the first marketable product. It is simple logic, as the court below stated (404 F.2d at 126), that bulk cement is the first marketable product because it is marketed and is the first point in the overall production

---

[6]Promulgated under the 1939 Code.

process where gross income from a product actually sold is available.

In defining gross income from mining, § 613(c)(2) of the 1954 Code provides that mining includes the treatment processes *"necessary and incidental"* to the extraction of minerals and the treatment processes specifically defined as mining.[7] The court below merely affirmed the trial court's finding that the grinding and blending of relatively insignificant quantities of purchased pre-kiln additives was incidental to the grinding and blending of respondent's mined materials. Contrary to the strained argument in the Petition (Pet. p. 14), the Ninth Circuit in *Riddell v. California Portland Cement Co.*, 330 F.2d 16, 17-18 (9th Cir. 1964), specifically stated that the government conceded that the blending of additives was a pre-kiln process and that the expense thereof is a mining cost.

---

[7] § 613(c)(2): "The term 'mining' includes not merely the extraction of the ores or minerals from the ground but also the treatment processes considered as mining described in paragraph (4) (and the treatment processes *necessary or incidental* thereto) . . . ." (Emphasis added.)

## CONCLUSION

This case does not create a conflict among the Circuits of important questions of law, nor, because of the unique factual issues involved, would it provide a decision of substantial importance in the administration of the federal revenue laws. Consequently, the Petition for a Writ of Certiorari should be denied.

Respectfully submitted,

JAMES LAWRENCE WHITE
500 Equitable Building
Denver, Colorado 80202
Attorney for Respondent

OF COUNSEL:

CLAUDE M. MAER, JR.
500 Equitable Building
Denver, Colorado 80202

HARRY R. HORROW
STEPHEN J. MARTIN
Standard Oil Building
San Francisco, California 94104

# In the Supreme Court of the United States

OCTOBER TERM, 1968

No. 1,279

UNITED STATES OF AMERICA, PETITIONER

*v.*

IDEAL BASIC INDUSTRIES, INC.

*ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE TENTH CIRCUIT*

## REPLY BRIEF FOR THE UNITED STATES

1. The essential thesis of respondent's opposition to the petition for a writ of certiorari is the argument that (Br. 5) "the courts are in agreement as to the objective and the legal principles" of the proportionate profits method and as to "the technique to be used". And, respondent claims, the grant of certiorari would only involve this Court (*id.*) "in the details of the computation".

This, however, is a wholly inappropriate characterization of the questions presented in our petition. For the decision of the Tenth Circuit in this case wholly ignores the basic postulates of the proportionate profits method of computing the depletion allowance



351-945—69

of an integrated miner-manufacturer and creates a wholly new method having no foundation in the statute or regulations.

As we have pointed out in more detail in the petition (pp. 7–9), the basic theory of a proportionate profits method is that every dollar of a miner-manufacturer's cost is deemed to produce the same proportionate part of the profits earned through sales of the first marketable end product. The theory requires that the miner-manufacturer's income from mining be determined by apportioning his gross receipts between the mining and nonmining phases of his operation in accordance with the ratio that his mining costs bear to overall costs. The initial step in the procedure is to classify each element of cost as a mining or nonmining expense. The basic premise of the method is that every element of cost must be characterized in this manner.

It is this last premise that the court below has abrogated in its decision to exclude post-manufacturing costs from the proportionate profits computation. And it is on this point that the decision below is in basic conflict with *Standard Lime & Cement Co.* v. *United States,* 329 F. 2d 939 (Ct. Cl.), and *Whitehall Cement Manufacturing Co.* v. *United States,* 369 F. 2d 468 (C.A. 3). In those decisions the Court of Claims and the Third Circuit made clear their view that post-manufacturing costs of shipping and marketing finished cement, such as those in issue here, bear no relation to a producer's limestone mining activities and therefore should be classified as nonmining costs. In result, under the reasoning of those two courts, these substantial post-manufacturing costs take their

proportionate share of income into the nonmining phase of the operation and accordingly reduce the integrated mining-manufacturer's depletion basis. On the other hand, even though the Tenth Circuit seems to recognize (see Pet. App. 6a–7a) the basic nonmining nature of these post-manufacturing costs, it has ignored the logic of this characterization. Rather, it has, in effect, allocated them ratably between the mining and nonmining phases of the operation, and thereby included in the depletion base part of the nonmining income attributable to these costs. Thus, far from involving simply "details", the Tenth Circuit's decision presents a substantially different method for determining the depletion basis of integrated miner-manufacturers and this approach cannot be harmonized with that approved by the Court of Claims and Third Circuit and set forth in the regulation.[1]

2. Respondent's effort to defend the decision below proceeds upon the assertion that respondent's (Br. 4)

[1] Respondent errs in asserting (Br. 3) that Treasury Regulations on Income Tax (1954 Code) Section 1.613–3(d) do not apply to its taxable year 1954 because they were not adopted until after this case was tried and that those regulations are materially different from the 1939 Code Regulations. Pursuant to powers granted in Section 7805(b) of the 1954 Code (see also Section 611(a)), the new regulations are expressly made retroactive, as their title indicates, to taxable years beginning after December 31, 1953. Further, as Section 1.613–3(d)(1)(ii) declares, the proportionate profits method "as described herein is merely a restatement of the method formerly set forth in the second sentence of Regulations 118, Section 39.23(m)–1(e)(3) (1939 Code)." As inspection of the regulations shows, this restatement reflects the interpretation of the 1939 Code Regulations in *Standard Lime* and *Whitehall Cement*—decisions which were retroactive without limitation—and gives such interpretation a uniform nationwide application.

"nonproducing costs * * * are different in kind from those incurred by other taxpayers who do not exclusively sell one mined-manufactured product such as portland cement and who might be required to allocate such costs among several products."[2] No attempt is made to explain this purported distinction and there is no basis for it. Regardless of how many products an integrated miner-manufacturer may sell, the proportionate profits method requires, as a first step, a division of *all* costs between the mining and non-mining phases of the operation. To be sure, if a taxpayer sells several distinct products, it may be necessary to allocate some post-manufacturing costs among more than one product. But this allocation can be made only after the cost is properly characterized as mining or non-mining. Thus the instant case may be one step less complicated than the application of the proportionate profits to a multi-product manufacturer would be, but the question in issue here—the proper characterization of post-manufacturing expenses—arises in exactly the same way and requires exactly the same resolution regardless of the number of products sold.[3]

---

[2] Apparently petitioner's phrase (Br. 4) "nonproducing costs" is synonymous with "post-manufacturing costs". The phrase "nonproducing costs" has not been used heretofore in this litigation and is not a term of art having an accepted meaning within the industry. In consequence we can only conjecture at its meaning.

[3] Respondent's attempt (Br. 5–6) to defend the characterization below of bulk cement as its "first marketable product" is at odds with its characterization of itself as (Br. 4) "a single product producer of cement." If, as respondent

2. Respondent's discussion (Br. 6) of *Riddell* v. *California Portland Cement Co.*, 330 F. 2d 16 (C.A. 9), entirely ignores that the Ninth Circuit quoted with approval a statement in the pertinent congressional committee report that a process (H. Conf. Rep. No. 20005, 86th Cong., 2d Sess., pp. 8–9) "is not treated as mining where applied to a purchased ore or mineral".[4] In this connection the court said (330 F. 2d at 18):

> We believe that by the enactment of the amendment in question Congress intended only to move the cutoff point from the crushing and grinding stage to the prekiln stage, but not to alter the revenue ruling with respect to separate computations of depletion of component minerals. To hold otherwise would be to allow a double depletion on the iron ore extracted by the taxpayer. This will not do.

---

product apparently concedes, portland cement is the same product regardless of the quantities in which it is sold, the court below was plainly wrong in its holding on this point. In no event has respondent explained away the conflict on this point with the decision of the Third Circuit in *Whitehall Cement Manufacturing Co.* v. *United States*, *supra*.

[4] It is correct, as respondent states, that the Government conceded in the Ninth Circuit that the cost of (330 F. 2d at 18) "physically adding the quartzite and iron ore to the limestone" is not a cost of mining. That concession however, occurred solely at oral argument, and did not then and does not now represent the position of the government. We would submit that it is particularly persuasive for present purposes that notwithstanding the "concession" of a point not there in issue, the Ninth Circuit's rationale is entirely inconsistent with treating the cost of physically adding additives as mining costs.

## CONCLUSION

The essential fact is that the decision below is in direct conflict with decisions of the Court of Claims and of the Court of Appeals for the [redacted] Circuit. The problem affects a substantial number of taxpayers, and, until this conflict is resolved, it is impossible for the Treasury to administer the statute in an equal manner. The petition for a writ of certiorari should be granted in order to settle the confusion and uncertainty resulting from these conflicting decisions.

Respectfully submitted.

ERWIN N. GRISWOLD,
*Solicitor General.*

MAY 1969.

U.S. GOVERNMENT PRINTING OFFICE: 1969

# In the Supreme Court of the United States

OCTOBER TERM, 1968

No. 1279

UNITED STATES OF AMERICA, PETITIONER

*v.*

IDEAL BASIC INDUSTRIES, INC.

*ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE TENTH CIRCUIT*

## PETITION FOR REHEARING

The Solicitor General, on behalf of the United States of America, petitions the Court to grant a rehearing of its order of June 2, 1969, denying a writ of certiorari and to grant that writ to review the judgment of the United States Court of Appeals for the Tenth Circuit in this case.

This petition is filed because of the decision the Court of Appeals for the Ninth Circuit rendered in *United States* v. *California Portland Cement Company,* Nos. 22,397 and 22,398, on June 4, 1969, two days after certiorari was denied here. That decision is printed as an appendix to this petition (pp. 1a–29a, *infra*). In it the Ninth Circuit has disagreed with the Tenth Circuit's disposition of two of the three ques-



354-899—69

tions presented in our petition for certiorari, thus reinforcing our contention that this Court should review this case in order to resolve the conflicts among the courts of appeals and the Court of Claims as to the proper resolution of questions affecting many taxpayers.

1. In the instant case the Tenth Circuit held that all of the respondent's post-manufacturing costs of storing, bagging, loading, transporting and selling cement should be entirely excluded from the proportionate profits computation. It also held that cement in bulk was respondent's first marketable product, even though respondent sells its cement both in bulk and in bags.

Although *United States* v. *California Portland Cement Co.* does not involve the full list of post-manufacturing expenses at issue here, the Ninth Circuit was called upon to determine the part that costs of bags and bagging and selling expenses should play in the proportionate profits formula. With respect to selling expenses, it applied recently adopted regulations together with proposed regulations and held that these expenses should be included in the computation and apportioned between mining and nonmining expenses. (App. 20a–25a.) [1] It specifically rejected the Tenth Circuit's holding that post-manufacturing expenses generally and selling expenses in particular should

[1] Treasury Regulations on Income Tax (1954 Code), Section 1.613–3(d)(1)(iii), added by T.D. 6965, published July 26, 1968, in 33 Federal Register No. 145, Part II, pp. 10692, 10694; proposed provisions Section 1.613–4(a), (c)(4) and (6), published 33 Federal Register No. 145, Part II, pp. 10700, 10707–10708. Oral argument of the instant case in the Tenth Circuit took place several months before the new final and proposed regulations were published. However, they are applicable in terms

be excluded from the proportionate profits computation. Rather, it reasoned (App., *infra*, p. 25a):

> [W]e reject the treatment of selling expenses adopted in *United States* v. *Ideal Basic Indus., Inc.*, * * * according to which selling expenses are entirely excluded from the computation. * * * To the extent that any items are excluded from the proportionate profits formula, a distortion results which affects the amount of the depletion allowance. The taxpayer's selling price for its cement takes into account the fact that certain selling expenses are incurred, and to retain the actual selling price in the formula while excluding certain expenses which are necessary in order to obtain the selling price is untenable.

The Ninth Circuit also held (App. 17a) that both the profits attributable to sales of bagged cement and the costs of bags and bagging must be included in the proportionate profits computation, and that the costs of bags and bagging are nonmining in their entirety. The Ninth Circuit relied on *Whitehall Cement Manufacturing Co.* v. *United States*, 369 F. 2d 469 (C.A. 3), the Tenth Circuit's own prior decision in *United States* v. *Portland Cement Co. of Utah*, 378 F. 2d 91, certiorari denied, 389 U.S. 975, and Treasury Regulations on Income Tax (1954 Code), Section 1.613(d)(1)(i), (iv), (v) and (d)(4)(iii), added by T.D. 6965, supra. (App. 13a–17a.) It again rejected the Tenth

---

to 1954, the last of the taxable years in issue here. Should the Tenth Circuit's decision here be reversed, the district court or the court of appeals should consider on remand the proper application of the regulations to the record here. Other portions of the regulations, adopted at the same time, require that all other post-manufacturing expenses in issue here be considered as entirely nonmining in character.

Circuit's ruling that post-manufacturing expenses—which include the costs of bags and bagging—are to be excluded. (App. 19a.) It said (*ibid.*), "[W]e do not find that the treatment of bag and bagging costs in *Ideal Basic* is consistent with other language of that opinion." It quoted and approved Judge Lewis' statement in dissent in the instant case (*ibid.*) that "(t)o eliminate all post-manufacturing costs destroys consideration of the representative market or field price of the first marketable product, * * * and thus seems * * * to reject the method itself".

2. *California Portland* does not involve the third question presented in this case—the treatment of costs of processing additives to the kiln feed, which are purchased from and depleted by another. Although the Ninth Circuit notes (App., p. 11a) its statement in *Riddell* v. *California Cement Co.*, 330 F. 2d 16, 18, that such costs are mining in character,[2] it goes on to hold that the costs of storing and handling additives were nonmining costs. Relying on the statutory scheme and *Riddell,* the court reasoned that a cost is not a mining cost merely because it was incurred during the pre-kiln stage; that the depletion allowance must be computed separately on each component mineral in order to avoid double depletion and depletion on purchased minerals; and that only the costs of mining processes applied to the mineral with respect to which depletion is to be allowed (here, calcium carbonate) are to be treated as mining costs in the proportionate profits computation. (App. 8a–13a.)

[2] That statement was based on an unauthorized concession of government counsel during oral argument of *Riddell.* See our reply brief in support of the instant petition at p. 5 n. 4.

This reasoning confirms the reading of *Riddell* advanced in the instant petition. It is, to be sure, confused by and inconsistent with the Ninth Circuit's statement in *Riddell* that costs of processing additives are costs of mining. But this confusion, we suggest, only serves to point up the need for an authoritative resolution and uniform application of the correct rationale.

## CONCLUSION

The decision of the Ninth Circuit in *United States* v. *California Portland Cement* widens the conflict among the federal courts and increases the confusion and uncertainty that now exists in determining the proper depletion allowance of miner-manufacturers of portland cement in particular and integrated miner-manufacturers in general. This petition for rehearing should be granted and a writ of certiorari should be granted so this Court may resolve the present uncertainty in the law.

Respectfully submitted.

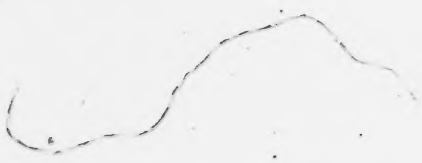
ERWIN N. GRISWOLD,
*Solicitor General.*

JUNE 1969.

## CERTIFICATE OF COUNSEL

Pursuant to Rule 58(1) of the Rules of this Court, I hereby certify that this petition for rehearing is presented in good faith and not for delay.

ERWIN N. GRISWOLD,
*Solicitor General.*



# APPENDIX

UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

No. 22,397

UNITED STATES OF AMERICA, APPELLANT

*v.*

CALIFORNIA PORTLAND CEMENT COMPANY, A CORPORATION, SUCCESSOR-IN-INTEREST TO ARIZONA PORTLAND CEMENT COMPANY, A CORPORATION, APPELLEE.

No. 22,397-A

CALIFORNIA PORTLAND CEMENT COMPANY, A CORPORATION, SUCCESSOR-IN-INTEREST TO ARIZONA PORTLAND CEMENT COMPANY, A CORPORATION, CROSS-APPELLEE

*v.*

UNITED STATES OF AMERICA, CROSS-APPELLANT

No. 22,398

UNITED STATES OF AMERICA, APPELLANT

*v.*

CALIFORNIA PORTLAND CEMENT COMPANY, APPELLEE

No. 22,398-A

CALIFORNIA PORTLAND CEMENT COMPANY,
CROSS-APPELLANT

*v.*

UNITED STATES OF AMERICA, CROSS-APPELLEE

JUNE 4, 1969

**APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE CENTRAL DISTRICT OF CALIFORNIA**

Before BARNES, DUNIWAY and ELY, *Circuit Judges.*

BARNES, *Circuit Judge:* This is an appeal from a judgment of the district court awarding taxpayer a refund of income taxes previously paid for the taxable years ending April 30, 1953 to 1959, inclusive. The district court had jurisdiction pursuant to 28 U.S.C. §§ 1346(a)(1) and 1402(a)(1), and we have jurisdiction of the appeal under 28 U.S.C. § 1291.

Initially, the taxpayer maintains that the government is collaterally estopped in the present case from attacking the depletion computation previously determined in litigation involving the taxable years ending April 30, 1951 and 1952. On two prior occasions, this court considered questions arising out of that controversey, and our opinions are reported at 397 F.2d 345 (1962) and 330 F.2d 16 (1964). The several opinions of the district court are unofficially reported at 3 A.F.T.R.2d 438 (S.D.Cal. 1958), 17 A.F.T.R.2d 782 S.D.Cal. 1962), and 18 A.F.T.R.2d 5424 (S.D.Cal. 1965). The last citation sets forth the method of determining the depletion allowance finally adopted in the 1951-1952 litigation, taking into account this court's two prior decisions in the case.

In light of the clear language of the district court in its final disposition of the 1951–1952 litigation, the taxpayer's claim in the instant case of collateral estoppel would appear to be without foundation. Finding of Fact No. 33, entered in the 1965 "stipulated" decision, (p. 5425) stated as follows:

33. By agreeing to the entry of the foregoing Findings of Fact and the following Conclusions of Law, the defendant has not waived his objections thereto nor does the defendant concede the correctness thereof either for the taxable years in suit or subsequent taxable years. Defendant has stipulated to the entry thereof to avoid another trial for the taxable years involved and so that final Findings of Fact and Conclusions of Law and a final Judgment may be entered without further delay. As to certain of the costs relating to the handling of additives ($21,390.00 for the taxable year ending April 30, 1951 and $14,321.00 for the taxable year ended April 30, 1952) herein treated as mining costs (see Finding of Fact No. 30, supra, Conclusion of Law No. 6, infra, and the computations shown in Exhibit A attached hereto), the defendant has not waived his objection thereto nor conceded the correctness thereof but has stipulated to such computations in order that final Findings of Fact and Conclusions of Law, and a final Judgment may be entered for the taxable years in suit without further delay.

It is well established that a judgment based on the parties' stipulation is only res judicata as to the period covered by the action, and is not enitled to collateral estoppel effect in an action for a later period. *United States* v. *International Bldg. Co.*, 345 U.S. 502 (1953); *Kennedy v. Mendoza-Martinez*, 372 U.S. 144, 157 (1963); *Erickson v. United States*, 309 F.2d 760, 768 (Ct.Cl. 1962); *Clark v. United States*, 281 F.2d 443, 446 (Ct.Cl. 1960); *Seaboard Air Line R.R. Co. v. George*

*F, McCourt Trucking, Inc.*, 277 F.2d 593, 596–597 (5th Cir. 1961); *Brawner v. Pearl Assurance Co.*, 267 F. 2d 45, 47 (9th Cir. 1958); *Abarr v. United States*, 153 F.Supp. 387, 389 (Ct.Cl. 1957).

The taxpayer's modes of production as they are relevant to the issues raised on this appeal are fully set out in our opinion in *Riddell v. California Portland Cement Co.*, 297 F.2d 345 (9th Cir. 1962), and need not be repeated here.[1] On the present appeal, the government contends that the court below erred with regard to the tax treatment of the following items: (1) costs of handling additives—whether these are mining or nonmining costs; (2) costs of bags and bagging—whether these are to be included when computing the cost of the first commercially marketable product; (3) selling expenses—whether these are to be excluded in computing the depletion allowance and, if not, whether they are both mining or nonmining expenses, or only nonmining; and (4) discounts given by taxpayer on the sale of its cement—whether these are trade or cash discounts. We will consider each of these items separately, in the context of the applicable code provisions, regulations and case law.

Initially, we note that taxpayer made a timely election pursuant to Public Law 86–781 § 4, 74 Stat. 1017, 1018, 26 U.S.C. § 613 note, to have all the taxable periods here in question governed by section 613 of the Internal Revenue Code of 1954, as amended by section 302(b) of the Public Debt and Tax Rate Extension

[1] It is necessary to cite volume and page of the previous decisions because they bear the same title of court and cause.

Act of 1960, P.L. 86–564, 74 Stat. 293. Thus, taxpayer's depletion allowance is to be determined by reference to the pre-kiln-feed cutoff point referred to in 26 U.S.C. § 613(c)(4)(F).

Under 26 U.S.C. § 611(a), the taxpayer is entitled to a reasonable allowance for depletion "in all cases to be made under regulations prescribed by the Secretary [of the Treasury] or his delegate." Pursuant to this authority, the Treasury Department on July 26, 1968, promulgated Treasury Regulations § 1.613, and more particularly § 1.613–3, relating to percentage depletion, applicable to taxable years beginning after December 31, 1953. *See* 33 Fed. Reg. 10692–10699 (1968). Such regulations may be given retroactive application. 26 U.S.C. § 7805(b). *Dixon* v. *United States,* 381 U.S. 68, 71–74 (1965); *Pollack* v. *Commissioner,* 392 F. 2d 409 (5th Cir. 1968); *United States* v. *Fenix & Scisson, Inc.,* 360 F. 2d 260, 267 (10th Cir. 1966). Further, when treasury regulations are reasonable interpretations of the statute in question, and are issued pursuant to statutory authority and are necessary to make the statute effective, they have the force and effect of law. *Commissioner* v. *South Tex. Lumber Co.,* 333 U.S. 496, 501 (1948); *Redwing Carriers, Inc.* v. *Tomlinson,* 399 F. 2d 652, 656 (5th Cir. 1968); *Weyerhaeuser Co.* v. *United States,* 395 F. 2d 1005, 1008 (Ct. Cl. 1968); *Estate of Willett* v. *Commissioner,* 365 F. 2d 760, 761 (5th Cir. 1966); *United States* v. *D. I. Operating Co.,* 362 F. 2d 305, 308 (9th Cir. 1966, *cert. denied,* 385 U.S. 1024 (1967); *United States* v. *Fisher,* 353 F. 2d 396, 398–

399 (5th Cir. 1965); *Whirlwind Mfg. Co.* v. *United States,* 344 F. 2d 153, 156 (5th Cir. 1965). *See also, Nutt* v. *Commissioner,* 351 F. 2d 452, 454 (9th Cir. 1965).

In the instant case, we conclude that the new regulations promulgated pursuant to 26 U.S.C. §§ 611 and 613 constitute a valid exercise of the Secretary's power. Therefore, taxpayer's liability for the last five of the tax years now in question—those ending April 30, 1955 to 1959, inclusive—is to be determined with reference to the new regulations (which were not considered in the prior litigation, or in the court below in the present proceedings, or in the parties' briefs on this appeal). Taxpayer's liability for the years ending April 30, 1953 and 1954, respectively, is to be determined with reference to Treasury Regulations 118, § 39.23(m)–1(e)(2) and (3), promulgated under the Internal Revenue Code of 1939. Both the old and the new regulations provide for the use of the proportionate profits method as an alternative method of computing gross income from mining, when there is no representative market price for the mineral product at the mining cutoff point, as in the instant case. The new regulations do not change the method, but set forth more specific applications of the method, as it relates to particular items in the cost computation, than are contained in the earlier regulations. This we will discuss in relation to the several issues raised on this appeal.

The government and the taxpayer are here agreed that the mineral with which we are concerned for

depletion allowance purposes is calcium carbonate. Thus, the district court correctly held in Conclusion of Law No. 4 (C.T. 188) that the appropriate allowance for the taxable year ended April 30, 1953 and for the first 245/365ths of the year ended April 30, 1954 is 10 per cent of the taxpayer's gross income from mining. Internal Revenue Code of 1939, section 114(b)(4)(A)(ii), as amended. That court correctly held also that the applicable allowance for the remainder of the taxable year ended April 30, 1954 and for the years ended April 30, 1955 through 1959, inclusive, is 15 percent of the taxpayer's gross income from mining. 26 U.S.C. § 613(b)(7), and (d).

## I. COSTS OF HANDLING ADDITIVES

The first question we must decide is whether the taxpayer's costs of handling the materials it added to its mined calcium carbonate rock are mining or non-mining costs, for purposes of computing the depletion allowance. The government maintains that these costs are not allocable to the mining operation, and that the district court's findings and conclusions in this regard are erroneous. Finding of Fact No. 14 (C.T. 182–183) stated the following:

> The mineral materials iron ore and quartzite were added by plaintiff to its calcium carbonate rock in the production of its cement clinker and finished cement. Said minerals were added in the raw grinding stage prior to the introduction of the raw mix into the kiln, and such process was an essential step in the production of cement clinker and finished cement from plain-

> tiff's calcium carbonate rock. Subsequent to acquisition by plaintiff but prior to actual admixture with plaintiff's calcium carbonate rock, said mineral materials were stored on plaintiff's premises and then moved to the point of admixture. Such storage and handling was a necessary part of the process of mixing said mineral materials with plaintiff's calcium carbonate rock prior to introduction into the kiln, and the cost of such storage and handling should be treated as a mining cost under the [proportionate profits method].

Conclusion of Law No. 5 (C.T. 189) stated:

> All of the processes applied by plaintiff to its calcium carbonate rock prior to the kiln-feed point, including the cost of physical addition of iron ore and quartzite (and their related storage and handling costs) in the raw grinding stage, were "ordinary treatment processes normally applied by mine owners and operators" and "mining" within the meaning of Section 114(b)(4) of the Internal Revenue Code of 1939, as amended, and Section 613(c) of the Internal Revenue Code of 1954, as amended.

The starting point for our analysis must be the Internal Revenue Code of 1954, as amended in 1960. Section 613(c)(4) therein provides:

> The following treatment processes where applied by the mine owner or operator shall be considered as mining *to the extent they are applied to the ore or mineral in respect of which he is entitled to a deduction for depletion* under section 611. (Emphasis added.)

Paragraph (F) thereunder (26 U.S.C. § 613(c)(4)(F)) provides that "in the case of calcium carbonates and other minerals when used in making cement—all processes (other than preheating of the kiln feed) applied prior to the introduction of the kiln feed into the kiln, but not including any subsequent process," shall be considered as mining. Section 613(c)(5) states that blending with other materials shall not be considered as mining, unless otherwise provided for in paragraph (4), or necessary to processes so provided for.

The regulations under the 1939 Code, as relevant here, provide that the term "mining" as used therein "includes not only the extraction of ores or minerals from the ground but also the ordinary treatment processes which are normally applied by the mine owners or operators to the crude mineral product after extraction in order to obtain the commercially marketable mineral product or products." Treas. Reg. 118, § 39.23(m)-(1)(e)(2). They also specify that the blending with other material is not included in the term "ordinary treatment processes" unless such a process is otherwise provided for, or necessary to a process otherwise provided for, or necessary to bring the ores or minerals into condition suitable for shipment. Treas. Reg. 118, § 39.23(m)–1(f)(2).

The latter provision was carried over into the new regulations, substantially unchanged. Proposed Treas. Reg. § 1.613.3(g)(1), 33 Fed. Reg. 10698 (1968). It also provided in said new regulations that:

> The term 'mining' does not include purchasing minerals from another. Accordingly, the proc-

> esses listed in this paragraph shall be considered as mining processes only to the extent that they are applied by a mine owner or operator to an ore or mineral in respect of which he is entitled to a deduction for depletion under section 611. The application of these processes to purchased ores, minerals, or materials does not constitute mining. Proposed Treas. Reg. § 1.613-3(f)(2)(iv), 33 Fed. Reg. 10697 (1968).

The above regulation is consistent with the Committee Report prepared in connection with Public Law 86–564 (June 30, 1960), wherein it is stated that under the new paragraph (4) of section 613(c), quoted above, "a described process is not treated as mining where applied to a purchased ore or mineral."

It is a general rule of construction that when statute is part of an organic whole, the statute should be viewed in context with the whole of which it is a part. *Stanford* v. *Commissioner*, 297 F. 2d 298, 308 (9th Cir. 1961). Thus, the various subsections of 26 U.S.C. § 613(c) must be construed, if possible, as consistent and interrelated parts of a single statutory scheme.

With this background, we turn to the specific facts of the case, bearing in mind that we are here concerned only with the computation of the depletion allowance on taxpayer's calcium carbonate. The taxpayer maintains that the costs of storing and handling its additives must be allocated to mining because these costs are incurred prior to the cutoff point provided for in 26 U.S.C. § 613(c)(4)(F), that is, prior to the introduction of the kiln feed into the kiln. The taxpayer also contends that these storing and handling

costs are analogous to the blending activities which were considered to be mining costs in *Riddell* v. *California Portland Cement Co.*, 330 F. 2d 16, 18 (9th Cir. 1964). (Said costs of physical addition or blending are not involved here.)

To the contrary, the government maintains that on the authority of the language of § 613(c) and the holding of this court in *Riddell* v. *California Portland Cement Co.*, 330 F. 2d 16 (1964), the costs of storing and handling additives must be allocated to the non-mining portion of taxpayer's activities.

We hold the contentions of the government are correct. The quartzite added by taxpayer was purchased, while the iron ore was mined by the taxpayer. For the ore, the taxpayer is entitled to a depletion allowance separate and apart from the allowance on the calcium carbonate. However, for the purpose of computing the depletion allowance on the calcium carbonate, we hold that only processes applied *to the calcium carbonate* prior to its introduction into the kiln, as one of the components of kiln feed, may be considered as processes of mining calcium carbonate. This construction does justice to § 613(c) as a whole, by allowing processes applied to the calcium carbonate to be treated as mining, while at the same time taking into account the kiln feed cutoff point. The holding is also consistent with the applicable regulations; it precludes a process incidental only to *blending* and the *production of cement* from being treated as mining, and prevents double depletion (with regard to the iron ore) and depletion on purchased minerals (with regard to the quartzite).

354-899—69——3

Further, this holding accords with past decisions of this and other courts. In *United States v. Cannelton Sewer Pipe Co.*, 364 U.S. 76, 78 (1960), the Court stated that the "ordinary treatment processes" contemplated by the statute are those normally applied by *nonintegrated miners* engaged in the *recovery* of the minerals. As the court below found in the present case, the addition of minerals to taxpayer's calcium carbonate "was an essential step in the *production of cement*" and the storage and handling of these minerals "was a necessary part of the process of *mixing* said mineral materials" with the mined calcium carbonate. Thus, the handling and storage costs were incurred only because taxpayer is an *integrated* producer, and said costs were not incurred in order to *recover* the calcium carbonate. The Court in *Cannelton* also stated that none of the processes to be treated as mining "destroy the physical or chemical identity of the minerals or permit them to be transformed into new products" (*Id.* at 86); that when the minerals "are in such a state that they are ready for industrial use or consumption . . . they have passed the 'mining' state on which the depletion principle operates" (*Id.*); and that gross income from mining stops where the *ordinary miner* ships the product of his mine (*Id.* at 87). This language provides further authority for our conclusion above. *See also, Riddell v. Monolith Portland Cement Co.*, 371 U.S. 537, 539 (1963); *Riddell v. California Portland Cement Co.*, 297 F.2d 345, 355 (9th Cir. 1962); *Vir-*

*ginia Greenstone Co. v. United States,* 308 F.2d 669 (4th Cir. 1962); *Iowa Limestone Co. v. United States,* 365 F.2d 63 (8th Cir. 1966); *Solite Corp. v. United States,* 375 F.2d 684 (4th Cir. 1967).

We find additional support for holding that the costs of handling and storing additives are not to be treated as costs of mining calcium carbonate in the decision of this court in *Riddell v. California Portland Cement Co.,* 330 F.2d 16 (1964). We therein held that a cost was not to be regarded as mining simply because it was incurred during the pre-kiln stage; that depletion allowance was to be computed separately with each component mineral in order to avoid double depletion and depletion on purchased minerals; and noted that only treatment processes *applied to the mineral* (here, calcium carbonate) are to treated as mining. Hence, for the reasons herein stated, we reverse the judgment of the district court with regard to taxpayer's additives.

II. COSTS OF BAGS AND BAGGING

The next question is whether taxpayer's costs of bags and bagging for its finished cement are to be included when computing the cost of the first commercially marketable product or products under the proportionate profits method. The government argues that the costs of bags and bagging, and the profits resulting from sales of bagged cement, should be included in the equation used to determine the depletion

allowance.[2] The taxpayer maintains that these costs and profits should be excluded from the formula, in accordance with Finding of Fact No. 21 of the district court (C.T. 184–185), and contends, in the alternative, that if these items are included then said costs should be allocated to both mining and manufacturing. Finding of Fact, No. 21, stated:

> The first commercially marketable product obtained from the calcium carbonate rock used in plaintiff's cement plants was bulk cement. Both the additional income attributable to plaintiff's selling a portion of its products in sacks rather than in bulk and the additional costs incurred as a consequence of selling such portion in sacks rather than in bulk are to excluded in the computation of plaintiff's percentage depletion allowances for the taxable years ended April 30 1953, April 30, 1954, April 30, 1955, April 30, 1956, April 30, 1957, April 30, 1958, and April 30, 1959.

Section 613(a) of the Internal Revenue Code of 1954, as amended in 1960, provides that in the case of mines and other natural deposits, the allowance for depletion under section 611 shall be the percentage, specified in subsection (b), of the *gross income*

[2] That equation was set out in our opinion in *Riddell v. California Portland Cement Co.*, 330 F.2d 16, 17 (9th Cir. 1964), and it also appears in Proposed Treasury Regulation § 1.613–3 (d)(1)(ii). It is as follows:

$$\frac{\text{mining costs}}{\text{total costs of product sold}} \times \text{gross sales} = \text{gross income from mining}$$

*See also. Whitehall Cement Mfg. Co. v. United States*, 369 F.2d 468, 471 (3d Cir. 1966).

*from the property.* Section 611 states that the allowance in all cases is to be made under regulations prescribed by the Secretary or his delegate.

The regulations under the 1939 Code provide in relevant part that if there is no representative market price for the taxpayer's crude mineral product, as here, "then there shall be used in lieu thereof the representative market . . . price of the first marketable product resulting from any process or processes . . . minus the costs and proportionate profits attributable to . . . the processes beyond the ordinary treatment processes." Treas. Reg. 118, § 39.23 (m)-1(e)(3).

The above provision was retained in the new regulations, with some explanatory material added. Proposed Treas. Reg. § 1.613-3(d)(1)(i), 33 Fed. Reg. 10694 (1968). It is therein stated:

> The objective of the proportionate profits method of computation is to ascertain gross income from the property by applying the principle that each dollar of the total costs paid or incurred to produce, transport and sell the first marketable product or group of products earns the same percentage of profit. Accordingly, in the proportionate profits method no ranking of costs is permissible which results in excluding or minimizing the effect of any costs incurred to produce, sell and transport the first marketable product or group of products.

Paragraphs (iv) and (v) thereafter provide in relevant part:

(iv) As used in this section, the term "first marketable product or group of products" means the product (or group of essentially the same products) produced by the taxpayer as a result of the application of nonmining processes, in the form or condition in which such product or products are first marketed in significant quantities by the taxpayer. . . . For this purpose, *bulk and packaged products are considered to be essentially the same product.* The first marketable product or group of products does not include a product or group of products additionally refined, beneficiated, altered, or manufactured as a result of the application of additional nonmining processes. For example, if a cement manufacturer sells his own finished cement of various types in bulk and bags and also sells concrete blocks or dry ready-mix aggregates containing additives, *the finished cement of various types, in bulk and bags, constitutes the first marketable product or group of products produced by him.* (Emphasis added.)

(v) As used in this paragraph, the term "gross sales (actual or constructive)" means the total of the taxpayer's actual sales to others of the first marketable product or group of products. . . .[3]

With reference to the costs of bags and bagging, it is stated in Proposed Treas. Reg. § 1.613–3(d)(4)(iii):

[3] The phrase "first marketable product *or group of products*" is not new to these regulations. It was used earlier in the Internal Revenue Code of 1939; section 114(b)(4)(B) therein referred to the oridinary treatment processes normally applied by mine owners or operators in order to obtain "the commercial marketable mineral product or products."

> In determining gross income from the property by use of the proportionate profits method . . . (a) The costs attributable to containers, bags . . . and similar items as well as the costs of materials and labor attributable to bagging . . . or similar operations shall be considered as nonmining costs.

Thus, the new regulations are clear that the costs of bags and bagging must be included in the proportionate profits formula, and that they must be allocated as nonmining costs. The earlier regulations also allow this result. Moreover, the case law (made prior to the promulgation of the new regulations) supports this conclusion. In *United States v. Portland Cement Co.*, 378 F.2d 91, 92 (10th Cir.), *cert. denied* 389 U.S. 975 (1967), for example, the court stated that the taxpayer's first marketable product was cement, and drew no distinction as to form of packaging. The court in *Whitehall Cement Mfg. Co. v. United States*, 369 F.2d 469, 471 (3d Cir. 1966), also stated that the taxpayer's first marketable product was finished cement, and specifically held that the packaging costs were "properly allocable to the nonmining operations." *Id.* at 474.

On the authority of the above regulations and cases, we hold that the costs of bags and bagging, and the profits attributable to sales of bagged cement, must be included in the computation of the taxpayer's depletion allowance, and that such costs are allocable to the nonmining part of taxpayer's operations.

Those cases cited by the taxpayer in support of a contrary result on this issue in our opinion are not controlling. In *Standard Realization Co. v. United*

*States,* 289 F.2d 247 (7th Cir. 1961), *Riddell v. Victorville Lime Rock Co., supra,* and *United Salt Corp. v. Commissioner,* 40 T.C. 359 (1963), *aff'd per curiam* 339 F.2d 215 (5th Cir. 1964), the courts were not applying the proportionate profits method, as we are here, for there was a representative market price for the crude mineral product. Instead, the courts were concerned only with determining the cutoff point at which mining ceased and, faced with this question, they held that the taxpayers were not entitled to include the costs of bagging in their gross income, because bagging was not a cost of mining. If there were a representative market price for ground calcium carbonate, we would not resort to the proportionate profits method in the present case, and would then exclude *all* nonmining costs from the computation.

The taxpayer also cites *Standard Lime & Cement Co. v. United States,* 329 F.2d 939 (Ct. Cl. 1964). This case held that the costs incurred by the taxpayer in packing cement in bags were post-kiln-feed costs and, therefore, not attributable to mining. *Id.* at 948. We agree with this holding. However, *Standard Lime* also then held that these nonmining costs were "indirect" costs and, for this reason, should be excluded from the depletion allowance formula. The only case cited by the court is *Standard Lime* in connection with its discussion of the costs of packing and containers, *Morton Salt Co. v. United States,* 316 F.2d 931, *cert. denied* 375 U.S. 951 (1963), provides no authority for drawing such a distinction between costs, and does not involve the proportionate profits method. We

conclude that there is no basis in the Code, the regulations, or case law for dividing nonmining costs into "direct" and "indirect" and excluding the latter from the proportionate profits formula, and we reject the distinction adopted in *Standard Lime*.

Finally, the taxpayer also relies upon the recent decision in *United States v. Ideal Basic Indus., Inc.*, 404 F.2d 122 (10th Cir. 1968). That case regarded bulk cement as the first marketable product, and excluded the costs of bags and bagging from the formula, on the authority of *Standard Lime* and *United Salt Corp.*, both *supra*. As previously discussed, *United Salt Corp.* does not stand for this proposition, and we are not persuaded by the reasoning in *Standard Lime*. Moreover, we do not find that the treatment of bag and bagging costs in *Ideal Basic* is consistent with other language of that opinion. Footnote 1 therein states that "the sales price of the first marketable product is to be computed on the identical physical material that is represented by total mining and nonmining costs." *Id.* at 125. However, it would appear from the opinion that the "mining cost" is computed on *all* the cement produced, while the "total cost of [bulk] cement" is only computed on the bulk cement. Thus, the numerator of the cost fraction includes costs for more cement than does the denominator. Moreover, as stated in the dissent in *Ideal Basic*, "[t]o eliminate all post-manufacturing costs destroys consideration of the representative market or field price of the first marketable product, a prime factor in the application of the equation, and thus seems . . . to reject the method itself." *Id.* at 128.

For the foregoing reasons, we reverse the judgment of the district court with regard to the costs of bags and bagging.

III. SELLING EXPENSES

The third question we must resolve is whether the taxpayer's selling expenses are to be included in the proportionate profits formula used to determine the depletion allowance and, if so, whether they are both mining and nonmining expenses, or only nonmining. The government's position is that these expenses should be included in the computation, and allocated to the nonmining category in their entirety. The taxpayer asserts the correctness of Finding Fact No. 22 made by the district court (C.T. 185), which provided:

> During the taxable years ended April 30, 1953, April 30, 1954, April 30, 1955, April 30, 1956, April 30, 1957, April 30, 1958, and April 30, 1959, plaintiff incurred certain selling expenses with respect to the products of its cement and lime plants. These consisted primarily of salaries and other expenses of salesmen and membership in various industry trade associations. Said selling expenses did not represent the cost of any process applied to plaintiff's calcium carbonate rock and are to be excluded in the computaiton of plaintiff's percentage depletion allowances for said taxable years. In the alternative, if the computation prescribed in Treasury Regulation 118, Section 39.23(m)–1(e)(3) were to be made on the basis of inclusion of costs other than direct process costs, said selling expenses should be allocated proportion-

> ately to both the mineral product and the manufactured product because such expenses were necessary to and of benefit to both of such products.

Section 39.23(m)-1(g) of Treasury Regulations 118 under the 1939 Code provides in pertinent part, with respect to the taxpayer's net income from the property for the purpose of the 50 percent limitation on the depletion allowance (see 26 U.S.C. § 613(a)), that "[d]eductions not directly attributable to particular properties or processes shall be fairly allocated." The section also states that in cases where the taxpayer engages in activities in addition to mining, deductions for general expenses which cannot be directly attributed to any specific activity shall be fairly apportioned between mining and the additional activities "taking into account the ratio which the operating expenses directly attributable to [mining] bear to the operating expenses directly attributable to the additional activities."

With regard to selling expenses, the new regulations, Proposed Treas. Reg. § 1.613-3(d)(1)(iii), 33 Fed. Reg. 10694 (1968), state:

> Those costs which are paid or incurred by the taxpayer to . . . sell . . . the first marketable product or group of products, and which are not directly identifiable with either a particular mining process or a particular nonmining process shall be properly apportioned to mining and to nonmining. In the absence of any specific provision of this section providing an apportionment method, such costs shall be apportioned by use of a method which is reasonable

in the circumstances. One method which may be reasonable in a particular case is an allocation based on the proportion that the direct costs of mining processes and the direct costs of nonmining processes bear to each other.

Section 1.613–4, paragraphs (a), (c)(4) and (6) thereafter provide in relevant part:

(a) *General rule.* The term "taxable income from the property (computed without allowance for depletion)", . . . means "gross income from the property" . . . less all allowable deductions . . . which are attributable to extraction or mining processes, including . . . selling expenses. . . . Expenditures which may be attributable both to the mineral property upon which depletion is claimed and to other activities shall be properly apportioned to the mineral property and to such activities.

(c) *Treatment of particular items in computing taxable income from the property.* In determining taxable income from the property under the provisions of paragraph (a) of this section—

* * *

(4) Selling expenses paid or incurred with respect to . . . a raw material [sic] product shall be subtracted from gross income from the property when determining the taxpayer's taxable income from the property. . . . In addition, a reasonable portion of the expenses of selling a . . . manufactured . . . product shall also be subtracted. . . . Such portion shall ordinarily be greater than zero, but not necessarily in proportion to other mining, extractive, nonmining, or postextractive costs. * * * In addi-

> tion, a reasonable portion of the selling expenses incurred by a producer of a . . . manufactured . . . product such as . . . cement . . . shall also be subtracted from gross income from the property.
> * * *
> (6) [A] reasonable portion of the trade association dues incurred by a producer of a . . . manufactured . . . product shall also be subtracted from gross income from the property. . . . The foregoing rule shall apply even though one of the principal purposes of an association is to advise, promote, or assist in the production, marketing, or sale of . . . manufactured . . . products. For example, a reasonable portion of the trade association dues paid to an association which promotes the sale of *cement*, . . . shall be subtracted from gross income from the property when determining taxable income from the property." (Emphasis added.)

From the foregoing regulations, it is clear that some selling expenses are normally allocable to mining operations, whether the taxpayer is in an integrated or nonintegrated industry. Furthermore, this is true even where the only product sold by the taxpayer has been manufactured by him.

The cases also support the conclusion that selling expenses should be apportioned between mining and nonmining in the proportionate profits formula. According to *United States* v. *Cannelton Sewer Pipe Co.*, 364 U.S. 76, 87 (1960), and cases based thereon, *e.g.*, *Virginia Greenstone Co.* v. *United States*, 308 F. 2d 669, 673 (4th Cir. 1962), *Standard Lime & Cement Co.* v. *United States*, 329 F. 2d 939, 946–947 (Ct. Cl. 1964),

*United States* v. *Light Aggregates, Inc.*; 343 F. 2d 429, 432 (8th Cir. 1965), and *Solite Corp.* v. *United States*, 375 F. 2d 684, 687 (4th Cir. 1967), the miner-manufacturer is treated as selling to himself the crude mineral that he mines, and the depletion provisions are to be applied so as to provide equal tax treatment for integrated and nonintegrated miners. It is recognized that nonintegrated miners incur certain selling expenses when disposing of their product on the market;[4] similarly, it would follow that the integrated miner, who disposes of a composite of a mined and a manufactured product, and incurs selling expenses on the total product, should allocate these expenses between the mining and nonmining portions of his activities in computing the depletion allowance. Otherwise, the nonintegrated miner would receive a tax advantage not intended by Congress.

Thus, we hold that if an expense is incurred for the benefit of the entire operation, as the district court found the selling expenses were in the present case, it can properly be allocated between mining and manu-

[4] See Rev. Rul. 60–98, 1960–1 CUM. BULL. 252, quoted in *United States* v. *Henderson Clay Prods.*, 324 F. 2d 7, 13 (5th Cir. 1963), which stated that where a mine operator sells his product through a del credere sales agent, the full selling price, unreduced by the sales commission, should be included in the computation of "gross income from the property" for percentage depletion. *See also*, *North Carolina Granite Corp.* v. *Commissioner*, 43 T.C. 149, 159, note 13 (1964), wherein the court stated that "[r]easonable selling expenses are normally considered as costs of mining"; and *United Salt Corp.* v. *Commissioner*, 40 T.C. 359, 370–373 (1963), *aff'd per curiam*, 339 F. 2d 215 (5th Cir. 1964), wherein the court permitted the taxpayer to allocate selling expenses to both mining and nonmining activities.

facturing. *See, Standard Lime & Cement Co.* v. *United States, supra* at 948. We further hold that the selling expenses in the instant case are to be allocated in the proportion that the mining costs bear to the total cost, in accordance with the finding and determination of the district court. This disposition finds further support in the decision in *Whitehall Cement Mfg. Co.* v. *United States,* 237 F. Supp. 838, 843–844 (E.D.Pa. 1965), *modified* 242 F. Supp. 327, 329 note 2, *aff'd,* 369 F. 2d 468 (3d Cir. 1966). Hence, we affirm the district court's alternative disposition of selling expenses, as stated in Finding of Fact No. 22.

At the same time, we reject the treatment of selling expenses adopted in *United States* v. *Ideal Basic Indus., Inc., supra,* according to which selling expenses are entirely excluded from the computation. (This was also the treatment first specified by the court below in the present case.) To the extent that any items are excluded from the proportionate profits formula, a distortion results which affects the amount of depletion allowance. The taxpayer's selling price for its cement takes into account the fact that certain selling expenses are incurred, and to retain the actual selling price in the formula while excluding certain expenses which are necessary in order to obtain the selling price is untenable.

## IV. DISCOUNTS

The final question for us to decide is whether the discounts given by the taxpayer on the sales of its cement were trade or cash discounts. Section 613(a)

of the 1954 Internal Revenue Code, as amended, states that the depletion allowance is to be based on the "gross income from the property." If it is determined that these were trade discounts, the amount of the discounts is deemed a reduction in sales price, and thus not includible in the taxpayer's total gross income. If, on the contrary, it is determined that these were cash discounts, the amount is treated as an expense to the taxpayer, and includible in gross income. *Standard Lime & Cement Co.* v. *United States, supra* at 947, note 18.

The government here contends that the discounts should be regarded as trade discounts, and that the taxpayer's gross income from the property should be based on the actual receipts rather than the list prices. The taxpayer maintains that these were cash discounts, and that the district court's findings and conclusions in this regard were correct. Finding of Fact No. 13 (C.T. 182) stated:

> Plaintiff offered to its customers, after sale, a discount of twenty cents per barrel of cement and discounts with respect to paving dust and ground calcium carbonate rock. Said discounts were offered by plaintiff for the purpose of inducing prompt payment of plaintiff's invoices and not to induce sales of plaintiff's cement, paving dust, and ground calcium carbonate rock. As practiced and applied during the taxable years ended, April 30, 1953, April 30, 1954, April 30, 1955, April 30, 1956, April 30, 1957, April 30, 1958, and April 30, 1959, such discounts were cash discounts and not trade discounts.

Conclusion of Law No. 6 (C.T. 189) stated:

> Plaintiff is not required to deduct from its 'gross income from mining' with respect to its Colton and Mojave mineral deposits any amount on account of the discounts allowed purchasers of its finished cement, paving dust (fines) and ground calcium carbonate rock.

There is no specific provision in the regulations pursuant to the 1939 Code dealing with discounts. However, Proposed Treas. Reg. § 1.613–3(e)(1)(i), 33 Fed. Reg. 10695 (1968), provides in relevant part:

> In the case of a taxpayer computing gross income from the property under the provisions of [the proportionate profits method], such [trade] discounts (if not otherwise taken into account) shall be subtracted from the gross sales (actual or constructive) of the first marketable product or group of products.

No definitions of "trade" and "cash" discounts appear in the Code or regulations. But in *Standard Lime & Cement Co.* v. *United States, supra* at 947, note 18, it is stated that cash discounts are granted to purchasers in order to encourage prompt payment, thus producing a quicker flow of working capital, and that cash discounts differ from trade discounts in that the latter are granted at the option of the seller no matter when payment is made, depending on market conditions. The court then cited Rev. Rul. 60-257, 1960-2 CUM. BULL. 197 and Rev. Rul. 55–13, 1955–1 CUM. BULL. 285, wherein it is further stated that a cash discount is *substantially equivalent to a charge in the nature of interest for use of the prepaid amount and represents a fair interest rate.*

It was stipulated in the court below (Stipulation No. 11, C.T. 140) that during all the taxable years in question the taxpayer offered to its customers, after sale, a discount of twenty cents per barrel of cement and discounts with respect to paving dust and ground calcium carbonate rock. It was further stipulated (Stipulation No. 2, C.T. 165) that during all the years in issue all of the major cement producers in the Los Angeles, California area offered discounts to all of their customers as follows. A discount of twenty cents (20¢) per barrel for payment by the tenth (10th) of the month following the invoice date or the net amount after thirty (30) days.[5] The evidence showed that only a small percentage of the discounts were ever disallowed. See C.T. 102–112. For example, during the taxable year ended April 30, 1957, the taxpayer allowed discounts in excess of $1,000,000 on sales from its Colton and Mojave plants, while it disallowed discounts for only $347.

With regard to the amount of interest allowed by the discount, a sample invoice filed with the court (C.T. 101) shows that the quoted terms were: "Net

[5] See Findings of Fact Nos. 22–25 in *Southwestern Portland Cement Co. v. United States*, 22 A.F.T.R.2d 5874, 5877 (C.D. Cal. 1968), wherein the court found that on sales from its California plant the plaintiff offered the same discount to its customers as the present taxpayer; that the plaintiff followed industry practice in quoting these terms; that the discounted price was offered primarily to encourage purchases in competitive situations; that immediate payment was insisted upon only when the plaintiff was concerned about the customer's credit standing; and that in all other situations the price was invariably permitted to be paid after delivery. The court then concluded that the discount was a trade discount.

and due 30 days from the date of issue—Interest at 7% per annum on overdue accounts. If payment is postmarked on or before the tenth of the following month, the amount of discount deductible is $[20¢ per barrel]." The price per barrel was $3.63; hence, the 20¢ discount was equivalent to about 5½%. This amount was allowed for prepayment of anywhere between 1 and 20 *days,* and when this amount is compared with the 7% *per annum* rate for overdue accounts, we cannot conclude that the discount represented a fair interest rate. Rather, in light of the interest rate stated, plus the fact that the discount was so rarely disallowed, plus the fact that the same discount was so prevalent in the industry, we hold that the discount allowed by the taxpayer was a trade discount and therefore is to be treated as a reduction in sales price. Hence, we reverse the judgment of the district court expressed in Conclusion of Law No. 6.

The judgment is affirmed in part and reversed in part, as indicated, and remanded for further proceedings not inconsistent with the views herein expressed.

U.S. GOVERNMENT PRINTING OFFICE: 1969

IN THE

# Supreme Court of the United States

October Term, 1968

**No. 1279**

UNITED STATES OF AMERICA, Petitioner

v.

IDEAL BASIC INDUSTRIES, INC.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE TENTH CIRCUIT

## RESPONSE TO THE PETITION FOR REHEARING

The Government bases its Petition for Rehearing on the decision rendered by the Court of Appeals for the Ninth Circuit in *United States* v. *California Portland Cement Company,* 413 F.2d 161, handed down on June 4, 1969 (two days after a writ of certiorari was denied in the instant case), alleging disagreement between the Ninth Circuit opinion and that of the Tenth Circuit with respect to the treatment in the proportionate profits computation of two expense items. One of these items, selling expenses, was treated by the Ninth Circuit contrary to the Government's position. It is noteworthy that the Government has not seen fit to file a petition for certiorari in the Ninth Circuit case.[1]

[1] The Ninth Circuit denied a petition for rehearing in the California Portland Cement case on July 1, 1969 (413 F.2d 161), and neither the Government nor the taxpayer has petitioned this Court for certiorari.

We respectfully submit that the Government's petition for rehearing provides no substantial basis for vacating the order denying its petition for certiorari, or for granting the writ. The alleged conflict in legal principles does not exist, and the most that can be said is that there is a difference between the Ninth Circuit and the Tenth Circuit in respect of the latter's essentially factual determination that cement in bulk was the first marketable product. The resulting difference in treatment of bags and bagging expense presents no important question of law, the issue being a minor accounting detail in the proportionate profits computation, without any significant effect on the revenues.

1. **Selling Expenses.** The Government strongly implies that there is a difference between the Ninth and Tenth Circuit decisions in the amount of the taxpayer's allowable depletion deduction, resulting from a difference in their treatment of selling expenses. Such a contention would be patently erroneous. While the court below in this case excluded selling expenses entirely from the proportionate profits computation, the mathematical effect of this treatment is the same—as the Government itself recognized in its reply brief, page 3—as the ratable allocation of those expenses between mining and nonmining. The Government there stated that the Tenth Circuit: "has, in effect, allocated them ratably between the mining and nonmining phases of the operation" (see, also, its original petition for certiorari, p. 6). This is precisely the treatment accorded selling expenses by the Ninth Circuit in the *California Portland Cement* case, wherein the Court stated, contrary to the Government's position in that case and in this case: "We further hold that the selling expenses in the instant case are to be allocated in the proportion that the mining costs bear to the total cost" (p. 172). There is not present here a conflict on any important question of law, nor is there any difference in tax effect;

there is merely a difference in the arithmetical method of arriving at the same result.[2]

2. **Bags and Bagging.** The treatment of the bags and bagging expense turned on whether the first marketable product obtained from the mineral was bulk cement or merely cement, whether in bulk or in bags. This narrow point affects the determination of the representative market price, and hence, the gross sales which are to be used in the proportionate profits computation.[3] The Tenth Circuit held that bulk cement was in fact marketable and that there was no earlier point where the goods in process could be sold. It excluded from the representative market price and from gross sales the extra amount received from customers for cement shipped in bags (the so-called "bag premium"). The related bagging costs were similarly excluded from the computation. Under the Ninth Circuit's decision, the bag premium must be added to the gross sales and the related bagging costs must be taken into account in the cost ratio. It will be entirely fortuitous in an individual case, depending on the relative profit on sales of cement shipped in bags compared with sales of bulk cement, whether the Tenth Circuit or the Ninth Circuit method is adverse to the revenues. In any event, this essentially factual point does not involve any important principle of law which warrants review by this Court.

3. **Additives.** No comment need be made on the third question presented—the treatment of the costs of grinding and blending additives into the kiln feed—since admittedly,

---

[2] See appendix hereto.

[3] There is no dispute in this case as to the proper cutoff point for the determination of the taxpayer's "gross income from mining." As pointed out on page 4 of the Petition for Certiorari, the cutoff point was fixed by statute, and by the taxpayer's timely election, at the point where the ground and blended raw materials were fed into rotary kilns (Pub.L. 86-564, 74 Stat. 290; Pub.L. 86-781, 74 Stat. 1017; I.R.C. 1954, § 613(c)(4)(F)).

this item is not involved in the *California Portland Cement* case, as the Government concedes (Petition for Rehearing, p. 3).

For the reasons stated in the Brief for Respondent in Opposition and those stated herein, we urge that the Petition for Rehearing be denied.

Respectfully submitted,

JAMES LAWRENCE WHITE
500 Equitable Building
Denver, Colorado 80202
Attorney for Respondent

OF COUNSEL:
CLAUDE M. MAER, JR.
500 Equitable Building
Denver, Colorado 80202

HARRY R. HORROW
STEPHEN J. MARTIN
Standard Oil Building
San Francisco, California 94104

## APPENDIX

The purpose of this appendix is to demonstrate that the treatment of selling expenses in the proportionate profits computation by the Ninth Circuit in the *California Portland* case and by the Tenth Circuit in the *Ideal Basic Industries* case produces the identical gross income from mining and hence the identical tax effect, even though different arithmetical methods are used to arrive at the same result.

### Assumptions

| | | |
|---|---|---|
| Cement sales | | $1,000 |
| Mining costs | $200 | |
| Nonmining Costs (not including selling) | 600 | |
| Total Costs (not including selling) | $800 | |
| Selling expense | 100 | 900 |
| Net Profit | | $ 100 |

### Ninth Circuit[1]

$$\frac{\text{Mining Costs } (\$200)}{\text{Total Cost } (\$800)} \times \text{Selling Expenses } (\$100) = \$25 \text{ allocable to mining}$$

$$\frac{\text{Mining Costs } (\$200) + \text{Allocable Selling Expense } (\$25)}{\text{Total Cost } (\$800) + \text{Total Selling Expense } (\$100)}$$

$$= \frac{\$225}{\$900} = \text{Mining Costs/Total Cost Ratio} = 25\%$$

Gross Income From Mining: 25% × Sales ($1,000) = $250

[1]Selling expenses are "to be allocated in the proportion that the mining costs bear to the total cost . . . . " (413 F.2d, p. 172)

### Tenth Circuit[2]

$$\frac{\text{Mining Costs } (\$200)}{\text{Total Cost } (\$800)} = \text{Mining Costs/Total Cost Ratio} = 25\%$$

Gross Income From Mining: 25% × Sales ($1,000) = $250

[2]"[S]elling costs are not a proper part of the computation." (404 F.2d, p. 126)